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Can Papua New Guinea Come Back From the Brink?

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EXECUTIVE SUMMARY

After seven months of wrangling, arrangements have finally been agreed to cover the deployment of more than 260 Australian police and other officials to Papua New Guinea (PNG) to help restore law and order. The 'enhanced aid' is part of a total Australian aid programme of over $400 million for 2004-05. This level of aid would amount to $2 billion over the next five years. The programme was unconscionably delayed over the question of immunity for Australian personnel when the Somare government suspended parliament in December last year to avoid a 'no-confidence' motion. This political uncertainty comes at a time when Papua New Guinea desperately needs a working government of national unity to consolidate and build on tentative signs of an economic recovery.

After three years of contraction GDP growth was at last positive in 2003, due mainly to a fortuitous combination of good weather at home and high commodity export prices abroad. Rising mineral prices have also revived interest in mineral exploration. Two major new resource projects are being negotiated—the Ramu nickel/cobalt mine to be developed by the Chinese government and the on-again, off-again 4,000 kilometre gas pipeline from Papua New Guinea's Southern Highlands to Queensland. But resource development, unless carefully managed, is a deterrent to agriculture, on which more than 85% of Papua New Guineans depend, and to job creation in urban areas.

Because population grew as rapidly as national income in 2003, per capita income growth was zero. If the expected 2.8% GDP growth is achieved for 2004, per capita growth will still be only 0.3%. Resource revenues have also led to waste and corruption, subsidising a small political elite at the expense of investment in roads, health and education. The lack of productive work is fuelling high crime levels. Civil strife and crime are so prevalent in the Southern Highlands where the gas project is to be located that its high costs are creating negotiating problems.

In a globalising world where human capital (skills, knowledge, training and education) rather than physical resources (gold, oil, gas and forests) are becoming increasingly important determinants of growth and prosperity, Papua New Guinea is being left behind. The present generation has been lost to warring clansmen and '*raskols*'. With less than half of school-age children in education and such poor health care that malaria and tuberculosis are rising and HIV/AIDS infections are exploding, it is now losing another generation.

Papua New Guinea requires major political and economic reforms if it is to step back from the brink. Security cannot be established without incomes from agriculture and jobs, the public sector cannot be reformed unless jobs are created for 'ghost' workers, and businesses cannot create jobs without security.

The new 'mutual obligation' framework for future Australian aid will only be effective if Papua New Guinea abandons the strategies and policies that have seen per capita incomes and living standards stagnate since independence in 1975. This paper sets out the economic reforms that could put Papua New Guinea on an annual growth path of 7% a year that would double its GDP every decade.

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I. A YEAR OF LOST OPPORTUNITIES

The Australian Financial Review reported in March that the International Monetary Fund gave the Papua New Guinea economy 'a rare tick of improving—healthy even if it is not yet strong'.[1] After three years of contraction, the economy grew by an estimated 2.5% in 2003. Good weather and high commodity export prices raised revenues and expenditure was contained. But with population growth of at least 2.5%, 2003 also marked the ninth year of negative or zero per capita income growth. For the majority of Papua New Guineans, living standards failed to rise.

The 2003-04 Budget entailed a 2.5% increase in import duties and higher stamp duties so that the cost of living rose. Domestic borrowing to boost revenues raised interest rates. Spending was cut in education, health and public sector maintenance. The balance of payments improved, because with stagnating living standards and investment, the demand for consumer and capital goods imports was depressed. The kina appreciated, bringing inflation down to 8.5%, but the kina's appreciation did not help palm oil, vanilla or other agricultural exporters. The favourable external conditions thus did not have the multiplier effects needed for the strong economic growth that could be expected after three years of negative growth[2]. The projected 2.8% growth rate for 2004 would only raise per capita income by 0.3%.

This paper argues that Papua New Guinea needs a decade of at least 7% per annum growth, doubling its income every decade, to bring it back from the brink. Unfortunately, instead of using the window of opportunity provided by good weather and higher world prices for exports to introduce the economic reforms needed to sustain long-term growth, the Somare government, like its predecessors back to colonial times, has continued to follow a resource development strategy. As in most other resource rich developing countries in Latin America, the Middle East and Sub-Saharan Africa, such development has created 'economic rents' (super profits from mining and natural forests) that provided revenues for a swollen government and public service. But an appreciating currency and upward pressures on wages hindered agricultural and industrial development. The hard kina policy in the early years of independence exacerbated the damage. Apart from increasing food for the rising population, agricultural production, on which more than 85% of Papua New Guinean families depend, stagnated. There has been almost no business growth or job creation to match the growth in population, which has nearly doubled since independence. Mineral and timber revenues have encouraged corruption and the lack of agricultural incomes and jobs has led to civil strife and rising crime.

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Exports

Papua New Guinea's low per capita merchandise exports illustrate the failure of its resource-based development strategy. Botswana is one of the few developing countries that has used resource revenues to diversify its economy and grow rapidly. Like Papua New Guinea, Botswana has substantial high-value mineral exports, but its total per capita exports are ten times Papua New Guinea's because it also has agricultural and labour-intensive exports. Mauritius' and Thailand's labour-intensive exports have enabled these countries to grow rapidly. Malaysia, with palm oil and other agricultural products, labour-intensive manufactures and mineral exports, has nearly 12 times Papua New Guinea's per capita exports.

Table 1: Merchandise exports per capita, 2002: Papua New Guinea, Botswana, Mauritius, Thailand and Malaysia

	US$
Papua New Guinea	324
Botswana	3,160
Mauritius	1,032
Thailand	1,056
Malaysia	4,300

Source: World Bank, *World Development Indicators, 2003* (Washington DC: World Bank, 2003).

Minerals

Although Papua New Guinea lies within the rich Pacific 'Rim of Fire', mineral exports peaked after exploration declined following Paguna and Ok Tedi corporate experiences, civil strife and crime. Rising mineral prices and taxation changes have revived exploration because rich mineral deposits can earn high profits even in countries that have poor security. The Somare government is negotiating two new major projects.

The Ramu nickel/cobalt mine is to be developed by the Chinese government. The China Metallurgical Construction (Group) Corporation is to provide 100% of the US$650 million financing; Papua New Guinea will own 35%. China has no experience, however, in open-cut mining in the tropics so that the project is likely to take time to come into production. China also has a very poor mine safety record. It will have to learn to negotiate with the local communal landowners who will own 5% of the project. As the sole customer, China, moreover, will be in a position to put a downward pressure on prices. In addition, substantial tax concessions are to be negotiated.[3]

The four owners of the Highlands Gas Project agreed to go ahead with a A$3.5 billion gas pipeline from the Southern Highlands to Queensland where Queensland Alumina was to be a principal customer at Gladstone. Negotiations with other customers were to follow once the engineering design, for which A$100 million was set aside for the next 12 to 18 months, was announced. Papua New Guinea's Resources Development Corporation had a share of 3.4% on behalf of the landowners, Oil Search Ltd had 54.2%, ExxonMobil Corporation had 39% and Nippon Oil Exploration had 3%. The Papua New Guinean government retained the right to buy, at market value, 22.5% of the project[4]. Unfortunately, negotiations have yet again collapsed.[5]

Negotiations are also proceeding on gold projects in Hidden Valley, Kainantu, Tolukuma, Simberi and Wild Dog.

Such resource projects are important, but they should be seen as the icing on the cake of labour-intensive agriculture, tourism and manufacturing that would provide the jobs and income needed to meet the aspirations of a young and growing population. The recent decline in mineral exploration and major new projects represented a window of opportunity to introduce reforms to build up the non-mineral sector of the economy and to ensure that future mineral incomes are used more productively in than in the past. New projects are reducing pressure for reform. The prospect that new mineral incomes will be used for development does not seem promising. Papua New Guineans would have been better served if their minerals stayed in the ground until their governments demonstrated the capacity to offset the 'economic rent' effects that deter agricultural production and job creation and until they used mineral revenues for development.

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Timber

Timber only accounts for 5% of Papua New Guinea's exports, but the depredations of timber exporting companies are a constant source of corruption and running sore for villagers.

The World Bank suspended the processing of a timber industry loan six months ago because it could no longer overlook the evidence of environmental damage and illegal operations by foreign-owned timber companies. The Somare government recently claimed that 'all is well' in the forestry sector,[6] but a *Pacific Magazine* report of an independent review of 14 logging operations concluded that serious breaches of Papua New Guinea laws continue. The principal allegations are that the companies are being granted unlawful extension of timber permits and that they fail to comply with their own environmental and logging plans. Other alleged breaches include underpayment and non-payment of landowner royalties, promised roads and bridges that are never built or that are built so poorly they soon collapse, and the employment of hundreds of immigrant workers employed in unskilled and semi-skilled jobs that could be done by Papua New Guineans.[7]

The Somare government has denied the validity of review's findings and the timber exporters, through the PNG Forest Industries Association, have also attacked the review.[8] It takes a long time for tropical forest to regenerate if it is not farmed rather than mined. Former forest areas on Mindanao in the Philippines are covered by grass too tough for animals to eat and may never recover.

Politics

Political maturity is essential if resource rents are to be harnessed constructively. But politics and the public service have come to be the principal path to the accumulation of wealth in Papua New Guinea. In the absence of secure private property rights and a significant private sector, political representation and the public service not only became the principal means of influence and power, but also of accumulating material wealth. Without the mass education effort that should have increased political capacity since independence, elections are still about candidates' promises and personalities rather than policies. The 2003-04 budget granted each member of Parliament K100,000 in addition to the K1million they receive for each electorate. An attempt has been made to establish procedures for expenditures under these grants through district planning and budget priorities committees and expenditures are supposed to go through a central supply and tenders control. But these controls are weak so that such funding still encourages the parliamentary instability that gives most candidates only one 'turn' to grab wealth for themselves and their clans.[9]

Political maturity is specific to each nation state. Australia's transfers of its social and political institutions to Papua New Guinea before and at independence are now widely seen as misguided. External attempts to guide Papua New Guinea's political development are doomed to failure. Political development is up to Papua New Guineans, and the limited preferential voting initiated by the former Morauta government has already reduced the violence that was a regular feature of past Papua New Guinea elections.[10] The path from a 'Potemkin' to a real democracy is tough but must be travelled if Papua New Guinea is to avoid experiences such as Haiti's.

The Australian enhanced aid offer is not a step toward re-colonisation, but an attempt to fill a gap that should not have been left 30 years ago.

Morality and security

No country has developed without law and order. Without greatly improved security, the proposed mineral projects are unlikely to come into production.

Leadership committed to stamping out corruption has been critical for the remarkable growth and development success of countries as different as Botswana and Singapore. Changing its moral standards is not an option for Papua New Guinea, but a necessity if it is to survive, let alone develop.

Enough information was available a year ago about such past corruption cases as the looting of the National Provident Fund to bring the perpetrators to justice.[11] No steps have been taken to do so. Pyramid schemes that extort savings from Papua New Guineans with promises of payouts of hundreds of kina are still thriving.[12]

Australian assistance to policing and making the existing legal system function before it disintegrates could be a catalyst for change. The enhanced aid offer is not a step toward re-colonisation, but an attempt to fill a gap that should not have been left 30 years ago. It will require considerable Papua New Guinea Government involvement and support to be effective.

Those who benefit from violence, crime and corruption are, of course, opposed to the enhanced Australian aid programme, hiding behind a façade of Papua New Guinea's sovereignty to protect their corrupt practices. They used the issue of indemnity for Australians working for the enhanced aid programme to avoid exposures of their own wrong doing. They fear that the proposed Australian programme could succeed because the majority of Papua New Guineans crave security: Ask any woman in village or township what she wants most for herself and her children; her first priority is always security.

While building a secure and honest civil society will take time, bringing corrupt public servants and politicians into courts, exposing their villainies and publicising them, would begin a shift to a new morality in public life. Some of the worst offenders would be likely to emigrate to save their skins. Their transfers of funds abroad and their applications for Australian residence are hopeful signs of the potential emigration of those afraid of exposure. An Australian investigative journalist would find a goldmine in following up purchases of property by Papua New Guineans in Queensland and pursuing current valuations of the *palazzos* from the Gold Coast to Port Douglas.[13] Similar funds have flowed to New Zealand.

Crime and violence

Corruption at high levels condones crime. *Raskol* leader Bita, waving a snub-nosed 38 special, cries that the nation's leaders are 'the great *raskols;* our leaders steal millions'.[14] The lack of productive and remunerative employment for those who drift to towns because there are no economic opportunities in villages, encourages prostitution, crime and drug abuse which in turn escalate robbery and assault. Crime and violence make the conduct of business impossible.[15]

In Port Moresby settlements such as Kaugere, Morata and Gerehu, gang warfare between Papuan and Highland gangs is reaching Port-au-Prince proportions with weapons ranging from machetes, bows and arrows to pistols, shotguns, M-16s and even Kalashnikovs. Ben Bohane in *The Bulletin* feared that 'unless the government starts to meaningfully tackle the urban drift, particularly of highlanders into Port Moresby there is the potential for ethnic conflict on a scale beyond that experienced in the neighbouring Solomons'.[16]

Highlanders are escaping districts that have already descended into chaos. Mendi police barracks in the Southern Highlands—where the gas pipeline headquarters are to be located—has become a shell with a 'leaking, holed, thrice condemned fibro police barracks where rain washes sewage through the houses'. Police estimate that there are 400 rapists and murderers, and between 1,000 and 3,000 military weapons in the district, but police are rationed to fewer than two litres of petrol a day. The Southern Highlands province 'lost' most of its $15 million of government funding in 2003. Part of it was said to be a pay-off for ballot rigging in the 2002 election. Nearly A$2 million found its way to Queensland.[17] Such fraud and corruption explains the lack of basic services in one of Papua New Guinea's richest provinces. Mt Hagen residents fear that they are next on the road to dereliction. And after Mt Hagen, Goroka?

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Infrastructure

Declining living standards are without doubt the principal cause of civic violence and crime. Girls help their mothers in gardens and orchards, and on coasts there is still some fishing, but most boys become men without ever having a job or an income. Such a high proportion of mineral revenues and aid flows has been wasted and stolen by public servants and politicians that little is left to maintain, let alone build new, infrastructure. It is estimated that 60% of Port Moresby's water supply is not billed. Provincial town water systems are a shambles. A Japanese funded water supply water tank at Lorgenau on Manus was recently blown up, apparently as a result of rivalry among officials. Not surprisingly, the Japanese International Cooperation Agency is holding up further water supply expenditures. When water gets cut off to markets, vendors cannot wash their hands so that typhoid and other diseases spread.

In a country brimming with hydroelectric potential, the proportion of the rural population with electric power is negligible. Town electricity supplies are limited and uncertain. Where emergency generators have been stolen from hospitals, patients can die in the frequent black-outs.

In February, 19 people were killed when a truck crashed off a poorly maintained road a mere 30 kilometres from Post Moresby.[18] Further out, lack of attention (by local, provincial and central governments) to road maintenance has interacted with civil strife and criminal attacks on passengers and goods to make roads impassable. Stopping can be fatal. The Lae–Mt Hagen Highlands Highway has been turned into a pothole-ridden goat track in spite of the millions of dollars of aid spent on it.

Longevity and health

Papua New Guinea is experiencing a continuing decline in the quality of health services. Most of the central government funds that reach provinces and local governments are spent on 'administration'. Those provincial governors interested in developing health care are caught between local 'big men' and central government in Port Moresby and their efforts are thwarted by Byzantine financial and inter-government legal arrangements that seem to be designed to facilitate corruption.

Papua New Guineans can expect to live less than 60 years (compared to Australia's 80 years). The very limited availability of clean water, sewerage and drainage is the principal reason for the low expectation of life.

Medical facilities range from poor in urban areas to non-existent in rural areas. Health expenditures are US$31 per head of population compared to US$191 in Botswana. During the last decade the number of doctors has not increased from 0.1 per 1,000 people and the number of hospital beds has fallen from 5.5 to 4.0 per 1,000 people.[19] Salaries swallow most of the health allocations, scarce equipment often migrates to private houses and there is little maintenance. Nearly 30% of staff are absent in rural areas.[20] Medicines are often short, even in Port Moresby and Lae.

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Malaria is returning and other mosquito carried diseases are rising. So is tuberculosis. Diarrhoeal diseases are responsible for a third of child deaths.[21] The breakdown of urban water supplies and the lack of water supplies in the country led to rising typhoid and other food and water born diseases. Domestic violence, other assaults, gang and clan fighting and motor vehicle accidents have led to growing numbers of physical injuries. Because health services are so few and medicines are so often short in health centres and hospitals, curable diseases and injuries often lead to death even in urban areas.

Ignoring sexually transmitted infections has resulted in an HIV/AIDS explosion. Official data greatly underestimate the number of infections, claiming a total of less than 8,000 HIV/AIDS cases.[22] Micro data suggest a much higher infection rate. For example, 10 in every 500 pregnant women coming to Angau Memorial Hospital at Lae are HIV positive. The actual numbers of people with HIV/AIDS infections is thought to be around 40,000.[23] Extrapolations of current infection trends suggest that one to one and a half million Papua New Guineans will be infected with HIV/AIDS by 2015-2020. Without effective treatment, this could reduce the labour force by a third.[24] The economic consequences would be dire. The misery of such an outcome—with dying mothers and fathers and generations of orphans on an African scale—can hardly be imagined.

Only a strong and determined government campaign can make inroads into HIV/AIDS. External aid funds and NGOs can only become effective in the context of a national effort. Thailand, a poorer country than Papua New Guinea after World War II, mounted a strong national campaign to bring HIV/AIDS (brought in by tourists in search of cheap sex) under control. It expects to see new HIV infections tail off by 2020 when Papua New Guinea, unless it immediately begins effective intervention, will be in the grip of an HIV/AIDS disaster. Thailand was able to devote health care and education resources created during 30 years of sustained economic growth (that included one of the best population planning programmes in the world) to deal with HIV/AIDS.

Education

Thirty years after independence less than half of Papua New Guinea's eligible school age children have been estimated to be in school.[25] Except in urban areas where literacy rates reach 70% to 80%, adult literacy is probably no higher than 25%. Education for girls is substantially lower than for boys, with many parents, notably fathers, still considering schooling for girls a waste of time.[26]

Educational data are highly misleading. Schools have inadequate basic facilities. They are badly maintained. Few schools have been built since the 1970s. Many rural schools do not have electricity, water and pit latrines let alone sewerage. There are not enough desks for pupils and often none for teachers. Even when salaries are paid regularly there is no money for writing paper and books. A radio is a luxury and libraries do not exist. Break-ins are nevertheless frequent, even in remote areas. Schools are frequently closed.

Villages have no accommodation for teachers. Some 15% of primary teachers are 'ghosts'; they receive salaries but are not on the staff of any school. The teachers who are in place frequently have to take two days off a fortnight to travel to cash their salary cheques. Rape is a constant threat to women teachers and girl students. School fees are a significant expense, often not spared for girls. Teacher absenteeism is high, yet students, particularly in remote areas, attend school regularly.

Education funding like health funding, seems designed to ensure minimal administrative efficiency and maximum opportunities for waste and theft. 'Leakages' of funds are substantial.

The material problems of education are not the main ones. Postmodern 'new Left' philosophy is dominant. Sixteen committees and reports, including two World Bank inputs, have progressively weakened the content of education. The Matane report of 1985 laid the foundations for an education system that 'helps individuals: identify basic human needs; analyse situations in terms of their needs; see these needs in the context of spiritual and social values of the community; and take responsible action in cooperation with others'[27] but fails to teach them to read, write and do arithmetic. Local languages and cultures are taught for the first years of schooling to the exclusion of basic skills, thus wasting the years when children are most receptive to learning maths and science, general knowledge, and languages. Where girls and boys from Norway to Singapore acquire maths and English, Papua New Guinean children are being denied access to the wider world of science, technology, the professions and trade. Of the few Papua New Guineans who proceed to postgraduate studies abroad, most can only take 'soft' humanities subjects so that there is a perpetual shortage of scientists, engineers, economists and other professionals whose places must be filled by expatriates.

II AN ECONOMIC REFORM AGENDA FOR PAPUA NEW GUINEA

Papua New Guinea's macroeconomic framework is a façade that has no depth of production and infrastructure. The reforms needed to create a working economy with jobs and incomes are well known. Unlike social and political institutions the liberal institutional framework for growth has proved to be internationally transferable.[28] Papua New Guinea can move quickly along tested paths if it wants growth and development.

Removing impediments to local entrepreneurship will be key. Chinese immigrants and their children and grandchildren have become local entrepreneurs in Papua New Guinea. Expatriates have been able to take advantage of monopolies and subsidies granted by the government. But there is no dearth of indigenous entrepreneurship in Papua New Guinea. The rapid initial take-up of export crops from coffee to vanilla, the women traders and the marked successes of a few businesses that have been able to overcome '*wantok*' pressures indicate that with secure private property rights, the rule of law and appropriate economic policies, Papua New Guinea would generate as many entrepreneurs as any other growth-oriented society. At present, however, the biases against indigenous business are overwhelming.

Land tenure reform and individual property rights

Communal ownership has not permitted any country to develop. In Papua New Guinea where 90% of people live on the land it is the principal cause of poverty. Communal ownership underlies the struggles over benefits from mineral rights and the depredations of timber exporters. Apologists point to a few examples of successful negotiation by foreign investors with local communities, but unhappiness of village landowners with mineral and timber projects is more typical.

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Changing traditional ownership to formal 'corporate' structures does not introduce individual property rights that are essential for individual savings and as collateral for credit and the development of banking. Their absence is the underlying reason for low levels of agricultural lending in Papua New Guinea.

Individual property rights require land surveys, registration and the organisation and endorsement of individual titles by the traditional landowning communities. These cannot be imposed, but require profound institutional changes that unseat 'big men' in favour of the majority and the rule of law. Complementary development of infrastructure is essential to give greater value to land so as to create a demand for individual property rights. Appropriate leasehold arrangements may also facilitate the transition to individual property rights. Land tenure reform is never easy, but it is absurd to argue, in the face of historical evidence from the whole world, that it cannot or should not take place in Papua New Guinea.

Regulatory reform

Papua New Guinean newspapers report, almost daily, that police bulldozed a market or stole betel nuts from a roadside woman seller. Presumably the police had not been paid their 'protection' money. Well-meaning colonial administrators gave Papua New Guinea Australia's regulatory, zoning and business frameworks that were totally inappropriate to a country at an early level of development because they encourage corruption. Such regulations persist, preventing the growth of the 'informal' trading that, by contrast, thrives in Asian villages, towns and cities.[29] The new office to which betel nut and vegetable sellers can complain if they are 'unfairly' treated has not been funded. Model regulations for urban and rural councils have been drafted but they have to be implemented if small business is to flourish and policing is to improve.

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Industrial relations reform

High unemployment and crime are closely linked. Although real wages were reduced by the Minimum Wages Board in 1992,[30] awards still specify inappropriate shift, weekend, holiday, long service pay and other on-costs that raise wages and salaries well above productivity[31] so that most attempts to establish internationally competitive labour-intensive export industries have failed.[32]

Many developing countries have used labour intensive exports to provide employment and move to a path of rising productivity and incomes (as the exports per capita table on page 2 shows). Singapore and Malaysia suspended industrial awards for five years for 'pioneer firms' investing in export production to cut unemployment. In Papua New Guinea such firms would require location in secure manufacturing estates and secure dormitories for workers. Niche labour-intensive product markets are still available. Papua New Guinea trade unions would have to give their support to such an initiative as the Malaysian and Singapore unions did.

Reducing protection

Protection—high tariffs and import restrictions for domestically produced goods—raises the cost of inputs, including labour costs, through high consumer prices and reduces standards of living. Papua New Guinea followed Australia's protectionist policies in the 1960s when other industrial countries were already freeing up trade in manufactures. The small size of the Papua New Guinea market means small production runs. Costs and prices are therefore high, further limiting the already small domestic markets. Beer is the principal exception because it can be produced efficiently on a relatively small scale, but it too is protected. Unnecessarily high tariffs protect inefficiency, high prices and extortionate profits.

The Morauta Government's July 1999 trade reform initiative—halving the average tariff to 10%—was to reduce high protective tariffs by 2006[33] but it was thwarted in 2000 and 2001 and has not been followed up by the Somare Government. Privileged consumer and construction goods still have high import barriers. Together with tax breaks and monopolies for favoured firms, this provides effective protection (protection on value-added in Papua New Guinea—that is, on wages and profits) of 100% and more. Such high protection for local value-added means that, in internationally competitive prices, much of the value-added in manufacturing in Papua New Guinea is negative. Employment creation in protected industries is minimal compared to potential employment in exporting industries. Nor have protected manufacturers improved their productivity over time as they promised. Sugar, food canning and cement are all well past the 'infant' stage.[34] They will never grow up. As most manufactures have high import components, the effect on the balance of payments, when lost exports are taken into account, is also negative, explaining persistent balance of payments difficulties. The principal beneficiaries are expatriate and foreign investors and their local cronies.

Increasing agricultural exports

Papua New Guinea's volume of, and earnings from, coffee, cocoa, tea and copra exports have declined since the 1980s.[35] Exports of vanilla were taken up following typhoons and civil war in Madagascar (the largest producer), but they still only amount to some US$5 million a year and represent just 4% of world vanilla exports. There is ample room for expansion, but will Papua New Guinea be able to compete as Madagascar recovers and world prices fall?

Palm oil exports are said to be a success story, with 11% a year growth in real earnings from the early 1970s. Papua New Guinea's climate and soils are ideal for palm oil, and the world market is growing rapidly with the economic rise of China. Wages have risen in Malaysia, the second largest exporter with 31% of world exports (after Indonesia's 56%), so that it is moving out of the industry.[36] Yet Papua New Guinea's share of the palm oil market in 2002 was still only 2%. Exports should have grown at 30% to 40% from the zero of the 1960s given Papua New Guinea's geographic advantages. Although several of the private nucleus estates are efficient, like all business in Papua New Guinea that does not benefit from special 'deals', they are burdened by heavy taxes. Yet there is little government funding of social or physical infrastructure in palm oil areas, increasing the costs to business in comparison to competitors in Malaysia and Indonesia.

PNG's climate and soils are ideal for palm oil, and the world market is growing rapidly with the economic rise of China.

Communal ownership limits the expansion of nucleus estates because they cannot purchase land but have to engage in elaborate leasehold arrangements to increase production. The smallholder palm oil sector has been crippled by communal land ownership. A $25 million World Bank smallholder palm oil project to be appraised and processed in 2004 (with the collaboration of the European Union) is mainly a maintenance project for five existing palm oil developments. It is to pay for the replanting of some 6,500 hectares of ageing palm oil smallholder blocks. Have the initial palm oil loans been paid off? Only 6,000 hectares of new land is to be planted by smallholders. Most of the funding is for roads and other infrastructure. If the World Bank project does not eventuate, palm oil production is likely to decline.[37]

Reducing the high cost of infrastructure

The lack of attention (local, provincial and central government) to road maintenance has interacted with civil strife and criminal attacks to make most roads in Papua New Guinea impassable. Aid pays for the bulk of the little maintenance that takes place. The Asian Development Bank reportedly constructed two kilometres of road in Chimbu in the first five months of 2004. The problem was not the terrain, but excessive manning, depredations, incompetence of expatriate staff and lack of attention by the Asian Development Bank supervisors. A 'rehabilitation' project for the Highlands Highway, 'the principal conduit for Papua New Guinea's exports that services a third of its population', is to cost US$113 million, dominantly in aid funds, to put back a road allowed to become impassable during the past 20 years. Another new agency, the Highlands Highway Authority, is to take US$5.4 million of this loan funding. The 'Highway' is already absorbing considerable AusAID and Asian Development Bank funds. Unless substantial changes take place, this highway project is going to go the way of past aid spending on roads.[38]

Colonial administrations established government-owned public utilities and many other enterprises, notably banking and superannuation for public servants. Publicly owned utilities—water, power, and telecommunications—are largely confined to urban areas. Being loss making, they maintain existing facilities poorly and cannot invest in expanding infrastructure. Wages and salaries and politicians' emoluments receive priority. These enterprises have continued in the public sector, with the concurrence of aid donors, despite their extremely high costs, long after the inefficiency of public enterprises was recognised worldwide. The Somare government has finally attempted partial privatisation in the sale of half of Telikom to an international firm.[39]

In Papua New Guinea corporatisation and privatisation only entered policy with the Morauta government, but even then faced strong opposition within the ruling political coalition. Most public enterprises are so run down that they have few viable assets. Private investors would be faced with large expenditures and long lead times before losses could be returned to profit, severely limiting private sector interest. The lack of security makes such investment dubious for foreign operators with effective public utility experience. Because public enterprises have been the source of lucrative incomes for employees, managers and directors, their reform continues to face formidable political opposition.

Governance and macroeconomic reform

Macroeconomic reform overlaps with microeconomic reform. Neither can succeed alone. Public services and enterprises have been unable to shed surplus workers because there is little new employment. Without shedding surplus labour, fiscal and hence monetary policies cannot be reformed.

The failure to match expenditures to revenues has been a major problem for Papua New Guinea.[40] Restructuring budgets is the key to macroeconomic reform. Prime Minister Somare's first reaction to making Australian taxpayers' aid contributions accountable was that Papua New Guinea did not need Australia's aid. Sir Michael was correct. But doing without aid would mean dramatic economic, social and political reforms.

The government would have to take immediate steps to bring budget expenditure under control. The 10% public service 'ghosts' who receive salaries but do not come to work, and perhaps another 10% of public service employees whose productivity is negligible, would have to be dismissed. The International Monetary Fund has financed a technical assistance computerisation project (at a cost of more than US$13 million[41]) and the World Bank has undertaken additional work to enable excess staff to be fired. All that is needed is the political will to act. Overseas high commissions, embassies, consulates and travel to meetings, conferences and seminars are extravagantly funded. An 80 strong delegation accompanied Sir Michael Somare on a recent trip to Beijing.[42] All such numbers could be cut sharply.

Accountability for public equipment purchases could eliminate present waste and corruption. Expenditures on expatriate advice could be cut to the bone without affecting the quality of policies. Several Papua New Guinea graduates are at present unemployed or grossly underemployed because they are unwilling to participate in implicit or explicit corruption. The Morauta government calculated the millions that would be saved by privatising public enterprises that are bleeding money. Simplifying taxation laws and eliminating so-called tax incentives (tax holidays) would reduce staff and increase revenues. Low and uniform tariffs would reduce numbers of customs officials. Simplifying immigration regulations would reduce opportunities for selling passports, staffing and queues in ports and airports.

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With reforms Papua New Guinea revenues would meet recurrent expenditure requirements and have enough over for investment programmes. Increases in agricultural production and employment would follow, so that Papua New Guinea would join those rapidly growing economies that enjoy expanding revenues.

To simplify and stabilise fiscal and monetary policy and hence lower inflation and reduce kina fluctuations, aid inflows must be separated from domestic revenues. Only then will the Papua New Guinea government know the value of its revenues and where its expenditures are going. It is essential to establish what has happened to past revenues from minerals, timber and fish and on what aid inflows have been spent. The development banks have been irresponsible in allowing the spending of concessional loans on recurrent expenditures.

Domestic revenues must over time cover recurrent expenditures and contribute to investment to a level that is at least equal, and for rapid growth, considerably higher than aid inflows. Domestic and foreign borrowing should be a last resort for adjustment to climatic disasters or falling export prices. Papua New Guinea must recognise that increasing worldwide productivity is leading to long-term primary (and secondary and tertiary) price declines so that its export productivity must rise if it is to be competitive. In times of high primary product prices debt should be retired, not increased.

III. CAN AID HELP PAPUA NEW GUINEA TO ACHIEVE GROWTH?

Australia contributed more than A$300 million of aid annually to Papua New Guinea between 2000-01 and 2003-04. Australian aid is expected to rise to well over A$400 million in 2004-05. Recognising past ties and geographic realities, Australia is the largest aid donor to Papua New Guinea and Australia's largest country destination for aid by a considerable margin. After independence, Australia took a 'hands-off' stance so as not to appear to pursue colonial policies, leaving it to the multilateral financial organisations—the IMF, the World Bank and the Asian Development Bank—to assist Papua New Guinea to grow rapidly and raise living standards. The years of Papua New Guinea's economic stagnation indicate that the multilaterals have not been able to fulfill this responsibility. Funds have flowed (at a cost to Papua New Guinean taxpayers) and hundreds of reports have been written, but Papua New Guinea's economy, and the social sectors particularly, are in dire straits. Australia has taken steps to coordinate the multilaterals' efforts to make aid effective. As a corollary it will have to engage in economic policy debates with Papua New Guinea to help it to a path to rapidly rising living standards.

Most Australian aid has been spent on maintaining roads and health and education services. AusAID has argued that the recurrent expenditures targeted are essential to maintaining living standards. But two problems have emerged. The Government has been able to avoid the reforms, including those suggested by Australia's and other donors' considerable expenditures on improving 'governance'. And Australian aid has not been able to stem the decline in roads, education and health. Australia's new, enhanced aid programme is thus designed to tackle some of the basic issues in law enforcement and administration. Several Australian government departments are now involved with aid to Papua New Guinea, so that inter-department collaboration on Papua New Guinea's problems and development possibilities has become essential.

While debate continues on whether any aid can be effective, it is widely agreed that aid cannot be effective if the recipient country does not follow constructive policies. Australian aid to Papua New Guinea can only succeed in a framework of 'mutual obligation' in which, in return for financial assistance, the Papua New Guinea Government pursues reforms that will remove the roadblocks to growth. Where reforms take place, Australian aid could perhaps be effective.

Australian aid to Papua New Guinea cannot be open-ended. Australian governments are accountable to taxpayers and voters so that aid has to be seen to be effective. This not only requires the strict accounting audits already in place, but monitoring and the evaluation of aid effectiveness. The Papua New Guinea component of 'mutual obligation' also has to be evident to Australian voters. If components of the aid programme are not working, they have to be suspended until performance improves. It is increasingly perceived that without rigorous implementation, future aid will have no more impact than the more than A$7 billion (in 2004 dollars) spent during the past 25 years.

Australian aid to PNG can only succeed in a framework of 'mutual obligation' in which, in return for financial assistance, the PNG government pursues reforms that will remove the roadblocks to growth.

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