

# Papua New Guinea

<b>Status Index</b> (Democracy: 6.00 / Market economy: 4.29)		<b>5.14</b>	<b>Management Index</b>		<b>4.18</b>
<b>HDI</b>	0.523		<b>Population</b>	5.7 Mio.	
<b>GDP p. c. (\$, PPP)</b>	2,619		<b>Population growth<sup>1</sup></b>	2.4%	
<b>Unemployment rate</b>	n/a		<b>Women in Parliament</b>	0.9%	
<b>UN-Education Index</b>	0.52		<b>Poverty<sup>2</sup></b>	n/a	
			<b>Gini-Index</b>	50.9	
Source: UNDP: Human Development Report 2005. Figures for 2003 – if not indicated otherwise. <sup>1</sup> Annual growth between 1975 and 2003. <sup>2</sup> Population living below \$ 1 (1990-2003).					

## A. Executive summary

This report will show that throughout the period of review, Papua New Guinea made little progress in its political and economic transformation toward a more liberal democracy and market-based economy, which would allow Papua New Guineans more freedom of choice. The country underwent a severe recession in the late 1990s and only started to recover slightly in the early 2000s. In 2003, the country posted positive GDP growth after three years of recession. This growth was consolidated in 2004 and 2005.

The positive developments during the period under review include: continuity in government leadership (most previous prime ministers were forced from office within a two year period), a mild economic recovery, sound economic policies, sustained stability in the exchange rate, an increase in reserves, and some elements of stability in political parties. In addition, improvements in civil society have been preserved. The institutional hardware of a market economy, such as basic rules in the organization of a market economy, is firmly in place.

The country faces some deeply rooted problems, however, that may impede the transformation process. The level of socio-economic development is low. Per capita income is now actually lower than it was at the time of independence. Years of poor governance, persistently high levels of corruption and a secessionist civil war on the island of Bougainville has taken a heavy toll on the country.

In the period under review, the currency, prices and economic growth were relatively stable. This situation is unusual because, for most of the 1990s, the country was unstable and endured consistent negative growth, rapidly falling exchange rates, and constant changes in government. Rumors of military coups, the forced resignation of a duly elected government by the military, the hiring of mercenaries by the

government, political instability and a breakdown of law and order also plagued the country.

Current economic development is based on foreign aid and a small but sustainable private sector. Property rights are well defined and, for the most part, enforceable. Although there is no welfare regime, cultural norms requiring the family to look after the weak compensate for the negative social side-effects of the capitalist system. Levels of political violence and extremism are low, but deficits in democratic transformation remain. For example, the rule of law is still weak, corruption persists at the highest levels and there continues to be tensions between tribal groupings. Ethnic or regional bias, gender discrimination, gridlock in politics, the deepening wealth gap and polarization between the political leadership and the general populace do not allow for a sufficient degree of consensus-building or for institutional efficiency in the democratic system.

Issues of concern for market transformation include consistency in economic and fiscal policies and an efficient bureaucracy. Other shortcomings include a high degree of economic dominance by big business and the need for further reforms in the financial and corporate sectors.

For the most part, deficits in transformation management must be attributed to the priorities, decisions and actions of the political elite. To some extent, however, the root causes of these deficits lies in cultural and historical issues. Nevertheless, Papua New Guinea has made some progress in political and economic transformation in the Pacific, a region that in recent years has suffered from deepening political conflicts, faltering democratic transformations, unbalanced economic growth, worsening socio-economic inequalities, military coups and devastating natural disasters.

The most significant event during the review period was the direct intervention by Australia, Papua New Guinea's former colonial master, to take over control of the country's bureaucracy and the police force in late 2004. This intervention will likely stabilize the entire country and it will help Papua New Guinea back onto its feet. While it is too early to assess the impact of this intervention, a similar intervention in the neighboring country of Solomon Islands suggests that it will be positive and will lay the foundation for a more stable country.

## **B. History and characteristics of transformation**

Papua New Guinea has always been a relatively open economy since its independence from Australia in 1975. Papua New Guinea's economy is dual in

nature, including a small formal economy and a much larger informal economy where subsistence farming accounts for the bulk of economic activity. About 85% of the population lives in the rural areas and population growth is relatively high at 2.5% per annum. The formal sector provides a rather narrow employment base, consisting of workers engaged in mineral production, a relatively small manufacturing sector, public sector employment and service industries such as finance, construction, transportation and utilities. A large portion of the population is engaged in the informal sector. Since independence there has been an urban drift, causing high urban unemployment, high crime and other related social problems.

Papua New Guinea's economic growth has been characterized by a heavy reliance on the mining and petroleum sectors. These two sectors contribute around 20% of government revenue and around 60% of export revenue. In recent years, agriculture, which accounts for about one quarter of exports, has expanded through cash crops such as coffee, palm oil, cocoa and copra. The other major export is raw timber logs.

Papua New Guinea is a constitutional monarchy with Queen Elizabeth II as the head of state. She is represented in Papua New Guinea by a Governor-General. The Governor-General is elected directly by members of the national parliament and performs ceremonial functions. Executive power lies with the prime minister and the cabinet.

Politics in Papua New Guinea has been marked by two distinct features. First, no government has completed a full term. More governments fall through votes of no confidence than in general elections. The average life of a government is less than three years. In Papua New Guinea it is not uncommon for a member of parliament to be elected as an independent and then join half a dozen political parties before the next election. In fact, most elected members of parliament start out as independents. The constant shifting of loyalties means that few governments have been safe from votes of no confidence – other than during the grace period of 18 months when a new government is formed and during the 12 months before a general election. Members of parliament regularly switch support in return for ministerial posts, perks and other financial inducements.

The current Prime Minister Michael Somare, who was also the country's first prime minister, may break this pattern. Through cunning political moves, patronage, sackings and adjournment of parliament, Somare has survived at least three serious attempts to topple him via votes of no confidence. If he remains prime minister until June 2006, he will be the first prime minister to serve a full five-year term.

The second feature defining politics in Papua New Guinea is the high level of corruption. Corruption reaches the very top echelons of government and is the single biggest cause of the country's decline since independence. Huge sums of money have disappeared into the pockets of politicians or have been misspent by successive governments. Despite this, there is very little political will to fight corruption as it permeates every level of politics and the bureaucracy.

One of the most significant political events in the country's history occurred in 2003 when the government signed an agreement, the Enhancement Cooperation Program (ECP), with the Australian government. Under the ECP, Australia will play a direct role in Papua New Guinea institutions. Australia will spend 2 billion kina in new aid money to resuscitate key Papua New Guinea's institutions such as the judiciary, the civil service and the police, which has failed to function effectively for the past two decades. More than 60 Australian civil servants are to be placed in key posts dealing with finance and planning issues and extra judges will be recruited and paid by Australia. An Australian will hold the key judicial position of Solicitor General (the government's chief legal advisor). The most controversial element of the ECP is the deployment of more than 200 Australian policemen to front-line policing roles to deal with the total breakdown of law and order.

## **C. Assessment**

### **1. Democracy**

Democratic transformation in Papua New Guinea advanced little during the period of review. Major shortcomings in democratic consolidation remain, particularly regarding political representation, rule of law, the effective and efficient working of the democratic institutions, and consensus building. In short, democracy has made little progress over the past several years in Papua New Guinea.

#### **1.1. Stateness**

There is no problem with state identity in Papua New Guinea. The state has an unrestricted monopoly on power. Definition of citizenship is not a politically relevant issue. All citizens have the same civil rights. There is separation of church and state although the constitution does state that Papua New Guinea is a "Christian" country. Many political parties claim to be guided by Christian principles, but in reality they have no policies and no organizational structure or capacity. The political process is

secular and freedom of religion is respected. More than 90% of the population is Christian.

Although state identity is not an issue, the country suffers from an inefficient, corrupt civil service, serious law and order problems, poor discipline in the army and police, and poor governance. There is almost universal cynicism toward political leaders who are seen as corrupt and self-serving. Most analysts see Papua New Guinea as an example of a weak state where the state is unable to implement even the most basic policies. Although the country is highly fragmented (there are an estimated 830 linguistic groups), the basic division in the country is between the highlanders and the people from the coast.

An exception to the issue of stateness is Bougainville. Bougainville is an island that is physically and culturally closer to the Solomon Islands than mainland Papua New Guinea. The people on Bougainville tried to gain independence in the 1970s but were unsuccessful. In 1989, a war of secession broke out and the issue remains unresolved today. In December 2004, the Papua New Guinea government unveiled a new constitution for the island, giving Bougainvillians a higher degree of autonomy. However, Francis Ona, leader of the main pro-independence group, has rejected the plan and has proclaimed Bougainville an independent state. It is unclear the extent of popular support enjoyed by Ona, but there is a significant number of Bougainvillians who prefer to be part of Papua New Guinea. The United Nations maintains a presence on Bougainville.

## **1.2. Political participation**

There is universal suffrage and elections have been held in a timely manner since independence. The next general election is due in mid-2007. However, serious problems remain with participation. Elections are neither free nor fair. Massive vote buying, ballot rigging, clan voting, violence, intimidation and cheating are widespread, especially in the Highlands. Election-related violence occurs during virtually every general election. During the 2002 elections, more than fifty lives were lost. Nevertheless, transfer of power takes place peacefully after the election results are announced, and the military and the police have generally kept out of politics. There are no problems in asserting constitutional rights to political organization, and non-governmental organizations (NGOs) play an active role in voter education and civil society. Political and civil organizations such as NGOs and trade unions can and do form freely. There are many NGOs and new ones are regularly established. The state-run and private media are mostly free from government influence, and the concept of a free media is widely understood and respected by all major players.

Newspapers regularly criticize government policies and expose corruption.

One area of concern is the low level of political participation by women, especially in leadership positions. The current parliament has only one female member. Since independence, there have been only four female parliamentarians. There is widespread political and cultural discrimination against women in the political arena, and women generally find it difficult to win elections. Discrimination against women is mostly cultural and is based on conservative beliefs that men are born to lead and women should look after the family and the household. This belief is particularly entrenched in the Highlands where, in some remote communities, women are extremely discriminated against.

### **1.3. Rule of law**

Rule of law remains a major concern. Transformation deficiencies exist in the system of checks and balances between the executive, legislative and judicial branches. The political executive (a cabinet led by a prime minister) dominates the political process. This means that the parliament has little say in political decision-making processes. The parliament itself is extremely weak due to the high turnover rate: in every election, more than 70% of incumbents lose their seats. Consequently, after every election, the number of new parliamentarians always outnumbers those with experience. Many of these novices have no real idea how parliament works. Part of the problem also lies with the parliamentarians. More than 50% lack tertiary education and most have only a rudimentary education. It is also not uncommon to find illiterate parliamentarians, especially from the more remote constituencies. Debates in parliament usually center on personal issues rather than on substantive policy issues. There are signs, however, that better educated candidates are being elected to parliamentary positions.

The judiciary, on the other hand, is widely seen to be independent and free of corruption. The courts often disagree with the government and issue their judgments accordingly. Many parliamentarians and senior officials have been jailed for corruption. Unfortunately, incompetence and a lack of resources have led to a drop in standards within the judiciary in recent years. There are hopeful signs that the resource problem will soon be resolved. Under the ECP, the Australian government will pay for 18 senior legal specialists to be placed in the Solicitor General's office, the Public Prosecutor's Office, the National Court Registry, and the courts.

There is an acute problem with the maintenance of law and order in Papua New Guinea. An official inquiry into the police force in 2004 revealed that discipline had

declined, corruption was pervasive and that the police regularly employ excessively violent tactics. Criminal gangs, called “raskols”, operate openly in all the major urban centers. These armed thugs are often better armed than the police. The production of homemade guns is a major cottage industry. In several surveys, the capital city of Port Moresby has been ranked as one of the most dangerous cities in the world in terms of personal safety. The deployment of more than 200 Australian policemen to support the local police force beginning in late 2004 should help bring to about an improvement although it is generally agreed that it will take more than a decade to rebuild a professional police force.

The biggest problem, however, remains the issue of good governance. Corruption is endemic among the political elite and the bureaucracy. Papua New Guinea ranks 102<sup>nd</sup> in Transparency International’s 2004 Corruption Perception Index. In theory, all parliamentarians and senior officials are subject to the “Leadership Code” (Organic Law on the Duties and Responsibilities of Leadership), a law governing their conduct while in office. Breaches of the Leadership Code can lead to dismissal from office.

Unfortunately, there is a purpose-built loophole in the code, enabling a person in breach of the code to escape punishment by simply resigning. Since the official is no longer legally defined a “leader”, he is no longer subject to the Leadership Code. Thus, many corrupt officials and politicians resign just before charges are brought against them under the code. There is also great reluctance to prosecute political leaders and other “big men” (men of influence) for fear of “payback”. This situation may improve in the coming years with the insertion of 36 economic and public administration specialists from Australia under the auspices of the ECP. These specialists will be placed in line positions to improve bureaucratic efficiency and to ensure that public funds are properly accounted for.

#### **1.4. Stability of democratic institutions**

Despite problems in the system of checks and balances, democratic institutions are remarkably stable. Institutional deficiencies are mainly due to poor governance, inefficiency and corruption. All relevant political and social players accept democratic institutions and regard them as legitimate. The central problem is that no government has ever served out a full five-year term. There is some evidence to suggest that this trend may be changing, however.

Throughout 2004, attempts were made to oust Prime Minister Somare through a vote of no confidence. Somare’s own coalition partner, People’s National Congress

(PNC), was among those plotting to replace him. Through a series of sackings, including throwing the PNC out of his coalition in May 2004 while simultaneously persuading an opposition party to join his coalition, Somare survived the challenge. Two other attempts to remove him from office were thwarted when Somare used his majority in a parliamentary committee to block the tabling of the no confidence vote. Somare also adjourned parliament three times for a total of nine and a half months between January 2004 and February 2005. If Somare manages to stay in power until June 2006, he cannot be removed constitutionally. Under existing laws, governments are protected by the constitution from no confidence motions for the first 18 months and the last 12 months of a five-year term. The last general elections were held in June 2002; the next general elections are scheduled for June 2007.

The main source of instability in other key institutions can be found in the overall instability of government. Every time a government changes hands, key personnel changes are made to reflect the policies of the new government or minister. Since the election of the Somare government in 2002, there have been several unsuccessful attempts to unseat Treasury and Finance Minister Bart Philemon and Governor of the Bank of Papua New Guinea, Wilson Kamit. The consistent economic and fiscal policy in the period under review is mainly due to the stability of these two entities.

### **1.5. Political and social integration**

Political parties remain weak in Papua New Guinea. Political personalities and patronage are still more important than political parties. Political parties are seen as vehicles to facilitate personal ambitions or simply as an entity needed to help form a government. Political parties tend to be driven by personalities and regional or clan ties. All political parties in Papua New Guinea lack organization, political philosophy or any real public policies. This has resulted in a high level of voter volatility.

The most recent attempt to remedy this situation was the passage of the Integrity of Political Parties and Candidates Law in 2001. The law restricts the ability of serving members of parliament to switch parties. Members of parliament can only move from one party to another under specific circumstance such as the dissolution of that minister's party. The idea behind the law is to make parties more important than the individual minister of parliament and thus reduce the number of "yo-yo" ministers who switch from party to party, based on personal benefits. Many votes of no confidence succeeded because of these "yo-yo" politicians. Three years after the passage of the integrity law, it is still unclear how effective the law has been. Individual ministers continue to switch parties and have challenged the law in the courts. Some parties have been divided: some party members are in government

while others sit on the opposition benches. Thus far, the courts have not ruled on any of these breaches of the law.

There are problems related to social integration in Papua New Guinea. Clan or tribe loyalties are generally stronger than loyalty to the state. In almost every urban center, hundreds of clan or regional associations promote clan or regional solidarity. In the highland regions, there are periodic fights between different tribes over issues such as compensation, land boundaries and “payback” killings. Toward the end of 2004, the highland town of Goroka was shut down for several days due to tribal warfare. During elections, clans reject national loyalties in favor of supporting other clans.

Despite these problems with social integration, there is strong support for liberal democracy among citizens. All relevant actors and groups understand that their interests are best protected by democracy.

## **2. Market economy**

### **2.1. Level of socioeconomic development**

Key indicators reveal a low level of development in Papua New Guinea. The country’s HDI ranking is 113 and its per capita real GDP is lower than at the time of independence in 1975. Social and poverty indicators remain poor, infant mortality is ten times higher than in developed countries, and the prevalence of HIV and AIDS is increasing. Efforts to eradicate poverty have been hampered by little growth in all sectors and a broken public service, especially in rural areas. Per capita GDP in Papua New Guinea was approximately \$664 in 2003 and \$757 in 2004. Despite recent positive GDP growth, Papua New Guinea's real per capita GDP in 2004 remains lower than that of 1994, reflecting an overall downward trend since 1994.

The country’s level of socioeconomic development does not allow adequate freedom of choice for all citizens. There is some evidence of social exclusion as a result of poverty, ethnicity, unequal access to education, and gender discrimination. Throughout the period of review, the country has not been able to reduce social disparities, poverty levels remain high and income disparity is getting worse.

### **2.2. Organization of the market and competition**

On paper, the institutional “hardware” for a competitive market-based economy is mostly in place. Papua New Guinea has made some progress in restructuring its

financial sector, including making the central bank more independent and establishing a commission on competition modeled on Australia's Competition and Consumer Commission.

In practice, there are significant barriers to the functioning of a free market. High establishment costs, problems with maintaining law and order, the high cost of banking, bureaucratic red tape and political corruption remain major barriers to market entry. Despite its public pronouncements, the country is not foreign investor-friendly. A maze of regulations and paperwork must be navigated before a foreign enterprise can start operations in Papua New Guinea. The Investment Promotions Authority (IPA), supposedly a "one stop" center for foreign businessmen, is often sarcastically referred to as the "Investment Prevention Authority."

The persistence of corrupt political leaders, combined with an incompetent and corrupt bureaucracy, often means that only businesses willing to pay bribes or "facilitation money" can win a significant advantage over competitors. Commissions of inquiry have found numerous instances of public tenders being awarded to companies or individuals who have bribed officials. Large and well-established companies have a significant advantage over newcomers. In recent years, the trend is for major companies to buy their smaller competitors and create an even stronger position. Among top businessmen, there is a lot of direct and indirect cross-ownership of businesses. Inadequate corporate governance is the norm rather than the exception.

Plans to privatize Telikom PNG, the government-owned monopoly, illustrate how a mixture of politics and business can derail the privatization process. The government announced in 2000 that it would sell 51% of its stake in the telecommunications company. After several rounds of bidding, Econet Wireless, a South African company, won the tender in 2003. The sale of the company faced strong opposition among Telikom employees who were used to low productivity and a poor work culture. It was an open secret that Telikom's payroll was 20-30% higher than what was needed. The opposition alleged that corruption was involved in the sale and that the sale price was far below true market value.

The role of the sale consultant, a former World Bank official who had been deported from Papua New Guinea by the Morauta administration, attracted much scrutiny. There was also a widespread belief that the sale would benefit foreigners working in tandem with selected Papua New Guinea elites. But what sank the deal in the end was a parliamentary motion brought by the son of the prime minister to stop the sale in November 2004. With this setback, privatization of other non-performing state assets such as Air Niugini has also come to a complete stop.

Trade unions and an outdated industrial relations regime have further impeded moves to free up the market. Trade unions, especially public sector unions, are strong and regularly threaten strikes. Many of the unions represent sectors that are unproductive or overstaffed. Any reforms will almost certainly mean job losses and the trade unions, often tied to political parties, have fought hard in the period under review to protect their constituents. In the 2002 general elections, the leader of the Papua New Guinea Trade Union Congress launched an unsuccessful bid as a candidate on a socialist platform.

Restructuring of the financial system has continued, but with only four banks in the country, there exists an unofficial oligarchy. One of the four banks, Bank South Pacific (BSP), controls more than 65% of the market and is the only bank with branches throughout the country. It thus holds an unofficial monopoly on rural banking. The other three banks, Australia New Zealand Bank (ANZ), Westpac and Maybank Papua New Guinea, concentrate mostly on business clients and can be found only in the country's urban centers. Banks in Papua New Guinea are inefficient: for example, local checks require five working days to clear.

While the bulk of foreign trade is conducted with Australia, Papua New Guinea's former colonial master, Asian businessmen are increasingly dominating the economy of Papua New Guinea. In the period under review, most new investments came from China and Malaysia. Papua New Guinea received little in terms of foreign direct investment due to the myriad economic and political problems in the country.

### **2.3. Currency and price stability**

Monetary policy in Papua New Guinea during the review period was aimed primarily at curbing inflation. Inflation was at around 8%–15% during the review period. The Central Bank also took steps to reduce interest rates and by 2004-2005, interest rates had fallen to under 10%. During the late 1990s, interest rates were as high as 26%. Foreign reserves were also up during the review period, helped by strong world commodity prices, especially for gold, copper, and oil. This underpinned a sharp rise in exports, thereby moving the external current account from a small deficit in 2002 to a surplus of 10% of GDP in 2003. The Papua New Guinea kina appreciated against the U.S. dollar by 20% during January 2003–April 2004. For most of 2004, the kina stabilized at around \$0.30. By the end of 2004, reserves had reached a high of US\$700 million. The stability of prices and currency from late 2003 onwards is largely due to the efforts of the treasury and the Governor of the Reserve Bank to maintain consistency in monetary policy. The ability of the government to keep the currency steady is commendable given that, for most the late 1990s and early 2000s,

the kina rapidly declined in value. In 1997, the kina was worth about \$0.60, by the end of 2002, it was worth only \$0.24. In the 1980s, the kina had been stronger than the U.S. dollar.

The Papua New Guinea kina is fragile and sensitive to political instability. If the government changes or new policies are adopted, another rapid decline in the kina is possible.

The central bank announced in 2004 that it intends to scrap control over foreign exchange. For many years now, businesses have been complaining that restrictions on the amount that can be remitted overseas (50,000 kina) were unrealistic. At the time of this writing, this policy announcement had not yet been implemented.

#### **2.4. Private property**

Papua New Guinea's market economy is overwhelmingly based on private ownership. Property rights and the regulation of property are adequately defined. However, large sectors of the economy remain under government control. For example, telecommunications, airlines, motor insurance and water supplies are all owned and operated by State Owned Enterprises (SOEs). In theory, these utilities are supposed to behave like private sector companies, but in reality they are characterized by a civil service culture and practices. All of these SOEs are laden with debt, antiquated equipment and a workforce that is both bloated and unproductive. Moves by the government to privatize these SOEs have met with strong resistance from trade unions and the opposition. Since 1995, the government has only managed to privatize one SOE, Bank South Pacific, after a bruising political battle. The current government has tried but failed to privatize Telikom, and it is unlikely that there will be a privatization of any more SOEs during the term of this administration.

It should be noted here that while property rights and the acquisition of property are adequately defined under the law, these laws apply to less than 10% of the land. More than 90% of the land in Papua New Guinea is not surveyed and is deemed as customary land. It is not possible under present laws to get a title to these lands and their traditional owners are commonly referred to as "landowners". Because these lands are not properly surveyed, disputes often arise over who the rightful "landowner" is. It is common for tribal war to erupt over land ownership disputes. Even land that has been properly surveyed and registered with the Lands Department can become the subject of landowner disputes. Often a tribe will claim "compensation" for land sold by their ancestors two or three generations ago, arguing that their uneducated and illiterate ancestors did not really intend to "sell" or give the

land to the state. Big projects are often plagued by landowner disputes, representing a major disincentive for big developers. Even land acquired by the state is not immune from land ownership problems. Water supply in the capital Port Moresby is periodically disrupted when landowners shut down the dam to demand “compensation”. Different factions of “landowners” periodically shut down major oil and gas projects because of compensation disputes or internal political arguments.

The government has no plans to survey land, as it is politically unacceptable. In the early 1990s rumors that the government was planning to survey land led to riots in Port Moresby.

The problem with traditional landowners is not unique to Papua New Guinea. In many other countries of the South Pacific, land ownership disputes are common, but the level of violence relating to those disputes is generally lower when compared to Papua New Guinea.

## **2.5. Welfare regime**

Papua New Guinea has no welfare regime. There is no national pension or health plan. Instead, welfare is based on familial and “wantok” support. Wantok (one talk) refers to people who speak the same dialect or language, signifying that the person is a relative or from the same clan. Social obligations based on reciprocity require one to aid a wantok. It is not uncommon for a house to be full of one’s wantoks, who stay as long as they wish and live off the owner of the house. Many cases of corruption in Papua New Guinea can often be traced to wantokism, or nepotism. Wantokism is especially rampant in the civil service.

Every working adult in full-time employment is required to join a provident fund, which is based on regular contributions from both the employee and employer. Prior to 2000, the state-operated National Provident Fund (NPF) was the only fund legally entitled to take contributions. This changed, however, when senior politicians colluded with senior NPF management to defraud the fund of more than PGK200 million, and nearly causing the fund to collapse in the late 1990s. New legislation was quickly brought in to allow the operation of private provident funds. Those involved in the fraud, including the brother of former deputy prime minister, have not been punished for their crimes.

There are now several private provident funds in operation. Because the formal sector is small, these pension funds cover only a very small proportion of the population and cannot really be seen as welfare.

The health system is for the most part broken. Major hospitals around the country are routinely shut down or are forced to scale back services because they did not receive their budget allocations on time. A registered nurse often staffs aid posts in the rural areas with no medicine other than paracetamol (acetaminophen). Others rely on donor support, especially from Australia, to keep the hospitals running.

## **2.6. Economic performance**

Throughout the review period, the Papua New Guinea economy grew modestly after three years of negative growth. Real GDP grew by 2.7% in 2003, by 2.8% in 2004 and about 2.6% in 2005. The overall balance of payments moved from an estimated deficit of 2.2% of GDP in 2002 to a surplus of 2.8% in 2003.

Economic growth was led by the agriculture and mining sectors. Coffee and cocoa production benefited from better weather conditions, and the production of palm oil, rubber, tea and copra oil also increased. Output of petroleum, gold, and copper was also higher during the period of review; relatively high oil prices contributed to economic growth. The government is committed to making the private sector the engine for growth. This strategy is appropriately called the “Export-Driven Growth Strategy”.

## **2.7. Sustainability**

Environmental concerns have grown in recent years among citizens, lawmakers and government officials. There are half a dozen NGOs actively pursuing environmental issues, especially against timber companies. Despite the strong presence of NGOs, government policy has often tended to support developers. The government’s commitment to economic growth as a basic strategy to reduce poverty means that environmental concerns are usually secondary concerns. In a recent World Bank review of timber projects, more than half the projects under review were found to have breached certain conditions, many of them related to the environment. Corruption is a factor in many instances where environmental concerns are ignored.

Papua New Guinea has an under-developed education system. Outside the main urban centers, schools lack even the most basic infrastructure. The standard of education now is lower than at the time of independence. Years of mismanagement, under-funding and fraud have meant there are very few good schools. Every year there are cases of travel funds stolen from teachers. Those who can afford it tend to send their children to international schools where the fees are often higher than the

salaries of a headmaster in a public school. The adult literacy rate in Papua New Guinea is less than 50%.

Although in 2002 the government established an intellectual property office in 2002, there are virtually no research and development activities in Papua New Guinea. The establishment of the intellectual property office was done more to comply with international obligations rather than because of the need to protect patents. There are moves to codify traditional knowledge, but these activities lack the necessary expertise and funds for proper management.

### **3. Management**

#### **3.1. Level of difficulty**

The level of difficulty in governing a country like Papua New Guinea cannot be underestimated. Since impendence, no government has served out a full five-year term. For the most part, politicians are self-serving, and almost every socioeconomic indicator has declined since 1975. Poor governance, high levels of corruption, the lack of adequate infrastructure, a small and unstable economy, aid dependency, low levels of education, ethnic conflicts and economic recession have all taken their toll on the country. The situation has become so bad that in recent years, Papua New Guinea has been reported to be on “the brink of collapse” and is a “failed state”. It has also prompted the government to accept the insertion of Australian public servants into line positions in the Papua New Guinea bureaucracy. Some 60 Australian specialists in financial controlling, accounting, law and economics began working in the country in late 2004. They will likely have a positive impact on establishing standards of good governance and making the public service more efficient.

### Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	3
System of government:	<i>Parliamentary</i>	Latest parliamentary election:	15-29.06.2002
		Effective number of parties:	19.3
Head of State:	<i>Queen Elizabeth II.</i> <i>Deputy: Sir Albert Kiplan</i> <i>Deputy: Sir Paulias Matane</i>		<i>until 06.2002</i> <i>since 29.6.2004</i>
Head of Government:	<i>Sir Michael Somare</i>	Cabinet duration:	<i>08/02- present</i>
		Number of ministries:	25
		Number of ministers:	25
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Effective number of parties denotes the number of parties represented in the legislature, taking into consideration their relative weight (Laakso/Taagepera index) = <math>1 / (\sum p_i^2)</math>; <math>p_i</math> is the share of parliamentary mandates controlled by party <math>i</math>. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

### 3.2. Steering capability

The government has generally demonstrated determination in its strategy of economic reform, but this has been hampered by corruption and by a non-performing bureaucracy. Infighting among the parties in the ruling coalition and frequent changes in leadership positions contributed to the country's malaise. Government departments often overspend their budgets. The size and payroll of the public service remains a central concern. Despite a hiring freeze, the number of public servants has gone up. There are at least 2,000 "unattached" officials that do no work but receive a full salary, a large number of "ghost workers", many underemployed casual workers, payments of unallocated allowances and benefits, and high rates of absenteeism.

### 3.3. Resource efficiency

The government does not make efficient use of available economic and human resources for its economic and social policies. The size of the public sector is a major concern. Although the budget looks good on paper, many budget systems and processes are repeatedly flouted. Appropriations are routinely breached and procurement procedures bypassed. Some of this is due to corruption while other misappropriations are due to incompetence or political interference.

One of the more competent government departments is the Central Bank and the Treasury and Finance Ministry. Reforms of the financial markets, banking sector and corporate sector have been planned adequately. Implementation, however, has been

mixed. The government has been relatively successful in some areas, such as in monetary and fiscal policy, while in others, such as education and health, the system is barely functioning. The budget deficits since 2002 have been largely under control during the review period with the budget surplus at 6% in 2004 and a deficit of 1% expected in 2005.

The institutional framework of governance in Papua New Guinea does provide for a high degree of coordination among conflicting political objectives. In 1999, the government established a Central Agencies Coordination Committee (CACC), which provided a degree of coordination and stopped the turf battles among the main government departments. The CACC also acts as a gatekeeper for cabinet submissions. Nevertheless, this has not prevented individual ministers from making decisions that conflict with government policy or go against the wishes of the prime minister. In such cases, the minister can be removed or shifted to another ministry. The problem is that the bureaucracy lacks the capacity to implement many cabinet decisions. Many decisions taken at cabinet level are not immediately implemented or are watered down by the time of the implementation.

### **3.4. Consensus-building**

All key political and social actors agree on the goal of a market-based, liberal democracy, and recognize the need for drastic reforms, although ideas about details and how to implement reforms vary greatly. There is no politically relevant actor with anti-democratic veto power but opposition parties, ruling parties, big business, labor unions and some societal associations have regularly blocked specific reforms. For years the bureaucracy has successfully resisted reforms. For example, discipline in the armed forces has collapsed, but attempts to reform the armed forces are met with threats of a military coup. An Australian-funded program to retrench a large part of the army and create a smaller professional force has met with limited success.

Although there are indications of a lack of consensus-building throughout the transformation process in Papua New Guinea, these are not signs of fundamental dissent about the direction of development toward democracy and a market economy. The Papua New Guinea Trade Union Congress (PNGTUC), long opposed to any economic reforms for fear of job losses, now appears willing to accept reforms as long as compensation for laid-off workers is generous.

There are also positive signs for consensus-building. There seems to be universal approval of the plan to insert Australian policemen into the Papua New Guinea constabulary. The problems with maintaining law and order, which have plagued the

nation since the middle of the 1980s, has reached such a stage that some of the raskol gangs are willing to reform if the state can guarantee personal safety and employment. There is also consensus that the future of the nation lies in economic recovery. Without economic recovery and growth, all other reforms will have little chance of success. Above all, there is complete consensus that there must be political stability and an elimination of corruption among the political elite. All strata of Papua New Guinea society see corruption among politicians as the biggest obstacle to political stability and recovery of the nation. Corruption permeates every level of politics, bureaucracy and business.

### **3.5. International cooperation**

Papua New Guinea is actively engaged in international and regional politics. For some time, Papua New Guinea has been the highest per capita aid recipient in the world. All three main multilateral agencies – the International Monetary Fund, the World Bank and the Asian Development Bank – are active in the country. The United Nations maintains a presence in Bougainville. However, the roles played by all external actors are regulated by Australia's activities, Papua New Guinea's former colonial ruler. Under the ECP, Australia is scheduled to direct more than PGK2 billion into Papua New Guinea to resuscitate the entire state. On top of this money, Australia gives more than A\$300 million annually to Papua New Guinea. All post-independence governments see foreign aid as the key ingredient in infrastructure development.

Papua New Guinea is also active in regional politics through the Melanesia Spearhead Group (MSG) and the South Pacific Forum. Papua New Guinea is the largest nation in the South Pacific other than Australia and New Zealand.

## **4. Trend of development**

### **4.1. Democratic development**

Even before the review period of this report, Papua New Guinea was a nation in crisis. Although it had all the institutions of a democratic state, most of these institutions were either not working or had been hijacked by interest groups. Corruption, poor governance, law and order problems and the easy availability of weapons means that democracy is procedural at best and a mirage at worst. There are signs that democracy may be strengthening, however. The current prime minister has survived several attempts to topple him and may be the first prime minister to

actually serve out a full five-year term, bringing much needed political stability. More importantly, in 2004, the Australian government inserted some 60 advisors to advise and run key government departments. If successful, this could bring a level of professionalism to the public services not seen since the first few years of independence.

The biggest impediment remains the electoral system. Despite the introduction of a limited preferential voting (LPV) system in 2003, there is evidence that it has not led to better quality candidates being elected into parliament. In fact, voting analysis of the LPV in several elections in 2004 suggests that the results of the elections would have been similar had the old “first past the post” (FPTP) system been used.

One positive development is that NGOs are getting stronger in demanding a corruption-free political system. A branch of Transparency International was established in Papua New Guinea recently and it has published studies on political corruption and held workshops to inform the people on the real costs of corruption.

#### **4.2. Market economy development**

Recent basic indicators of social and economic development show that most criteria related to human development, gender equality and education levels have largely remained the same with no tangible improvements. The only area where there has been slight progress is in the area of economic development. The country emerged from recession in 2003 and has seen positive growth in 2004 and 2005. Assuming that the Somare government remains intact, there is no reason to doubt that there will be positive growth until at least 2007. Inflation, which has now been brought down to single digits, is expected to decline steadily to 2% by 2009, assuming that fiscal and monetary discipline is maintained. The external current account is projected to be balanced from 2006 to 2009, with higher non-mineral exports only partly offsetting the decline in mining and petroleum exports as existing resources are depleted.

The one exception to these positive trends is income distribution measured in terms of the Gini index: recent empirical data show a minor deepening of income inequality.

**Table 2: Development of socioeconomic indicators of modernization**

	HDI	GDI	GDP index	Gini index	UN Education Index	Political representation of women <sup>a</sup>	GDP per capita (\$, PPP)
1999	0.534	0.530	0.53	50.9	0.66	1.8	2,367
2004	0.542	0.536 (2002)	0.52	50.9	0.57	0.9	2,272 (2002)

<sup>a</sup> Percentage of women delegates in Parliament after 1997 and 2002 elections.

Sources: UNDP, Human Development Report, 2001, 2004

Papua New Guinea's main exports consist of commodities that are vulnerable to world price fluctuations. The mining and petroleum sectors have been boosted by a new tax structure, but there are fears that mining and petroleum receipts may start go down as early as 2006 before it goes up again. The much talked about Papua New Guinea-Queensland pipeline, which will inject more than PGK3 billion into the economy has yet to take off. Even the design phase has not yet commenced. The issue facing the country is the pace of reform: there is fear that reform momentum will slow down as the country heads toward the 2007 elections.

**Table 3: Development of macroeconomic fundamentals (2000-2004)**

	2000	2001	2002	2003	2004
Growth of GDP in %	-1.3	-3.5	-2	2.7	2.5*
Inflation in % (CPI)	15.6	9.3	11.8	14.7	7.4*
Unemployment in % (estimates)	38	39	41	40	40
Budget deficit in % of GDP	-2.3	-3.9	-3.8	-1.1	-1.5*
Current account balance in billion \$	299	204	-20	346*	176*

\* estimates

Source: *Asian Development Bank, Asian Development Outlook 2004* (Oxford and New York, 2004); Bank of Papua New Guinea; author's own calculations

#### D. Strategic perspective

The general picture of transformation in Papua New Guinea is slightly positive. Although the country has some measure of political stability and has achieved economic growth, these gains are fragile and could easily be reversed. All key institutions, such as the parliament, the political executive, and the private sector, are weak. The country's low levels of social, economic and democratic development suggest that future transformation tasks will focus on incremental and piecemeal measures of deepening reforms in both dimensions of transformation and less so on fundamental tasks for the establishment of a market economy and/or liberal democracy.

In the dimension of democratic transformation, five major issues remain: political stability; corruption; electoral campaign reform; gender issues; and law and order.

These issues have been discussed again and again, and all past reform programs have either faltered or failed miserably. While there is political consensus between the elite and civil society to deal with these five major issues, the mechanisms to implement reforms either are too weak or are hijacked by vested interests.

This is where the Australian-funded ECP program is so crucial to reform. Papua New Guinea has tried for nearly two decades, but failed. External intervention appears to offer a chance for the nation to recover and consolidate democracy.

Market economic reforms include keeping the currency stable, consolidating economic gains, keeping government spending under control, privatizing state-owned enterprises, maintaining law and order, eliminating red tape, removing invisible barriers to new business, and removing unnecessary and unfriendly impediments to foreign investment. The past two years have seen modest economic growth and strong attempts to reign in spending. The main fiscal challenge is to ensure that the budget deficit averages less than 1% of the GDP in 2005 and beyond to allow for a gradual decline in the public debt-to-GDP ratio.

This gives the government a window of opportunity to implement needed reform in other areas. Here too the ECP will play a major role in assisting Papua New Guinea to reform. The ECP is designed to help Papua New Guinea in all the key areas that need reform and provide the foundation for sustained economic growth and political stability.