

BTI 2008 | Papua New Guinea Country Report

Status Index	1-10	5.46	# 70 of 125	
Democracy	1-10	6.10	# 62 of 125	➔
Market Economy	1-10	4.82	# 84 of 125	↗
Management Index	1-10	4.57	# 83 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	5.9	HDI	0.52	GDP p.c.	\$	2,280
Pop. growth ¹	% p.a.	2.0	HDI rank of 177	139	Gini Index		50.9
Life expectancy	years	56	UN Education Index	0.52	Poverty ³	%	-
Urban population	%	13.4	Gender equality ²	-	Aid per capita	\$	45.1

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Throughout the period of review, Papua New Guinea made some progress in its political and economic transformation toward a more liberal democracy and market-based economy, allowing Papua New Guineans more freedom of choice. The country underwent a severe recession in the late 1990s, and a slight recovery began in the early 2000s. In the past two years, the country achieved a growth rate of approximately 3.7% in 2006 and is projected to grow by 4.4% in 2007.

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), economic recovery, sound economic policies, stability in the exchange rate, an increase in reserves, peace on the war-torn island of Bougainville, 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 socioeconomic development is low. Per capita income is now actually lower than it was at the time of independence. Years of poor governance, tribal wars, breakdowns in law and order, and persistently high levels of corruption have 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 in 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 in urban areas and are, for the most part, enforceable. In rural areas, land title and land ownership is based on customary law, and basic facts – who owns it, who can sell it – are often in dispute. Although there is no welfare regime, cultural norms that require the family to look after the weak compensate for the negative social side-effects of the capitalist system. Levels of political violence are moderate (political violence occurs during election years), but deficits in democratic transformation remain. For example, the rule of law is still weak, corruption persists at the highest levels, and there are continuing tensions between tribal groups. Ethnic or regional bias, gender discrimination, gridlock in politics, a deepening gap in income equality, 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 lie in cultural and historical issues. The most significant event during the review period was the almost total breakdown in relations between Papua New Guinea (PNG) and Australia, PNG's former colonial occupier. Since independence, Australia has provided more aid to PNG than all other countries combined, and continues to give more than AUD 300 million a year. Needless to say, it is also the biggest foreign investor in the country and the most important trading partner. The breakdown in the relations between these two countries is due mostly to political reasons, while economic relations were relatively unaffected by this political quarrel.

History and Characteristics of Transformation

Since achieving independence from Australia in 1975, Papua New Guinea has always been a relatively open economy. 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 rural areas, and annual population growth is relatively high at 2.5%. 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. Most 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 generate 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 exhibits two distinct features. First, no government has completed a full term in the past two decades. More governments have fallen 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. This constant shifting of loyalties means that few governments have been safe from votes of no confidence. Members of parliament regularly switch support in return for ministerial posts, perks and other financial inducements. However, this pattern was broken recently. Current Prime Minister Michael Somare, who was first elected in 2002, will complete a full five-year term in 2007. The second defining feature of Papua New Guinean politics is the high level of corruption. Corruption reaches the top echelons of government and the bureaucracy 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 squandered by successive governments. Despite this, there is very little political will to fight corruption, since it permeates every layer of politics and the bureaucracy.

One of the most significant political events in the country's recent history occurred in 2003, when the government signed an agreement, the Enhancement Cooperation Program (ECP), with the Australian government. Under the ECP, Australia pledged PGK 2 billion in new aid money to resuscitate key Papua New Guinean institutions such as the judiciary, the civil service and the police, which have 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. More than 200 Australian policemen will be on the ground to deal with the total breakdown of law and order. While the community welcomes the ECP, several nationalist politicians decried it as a "re-colonization" by Australia and challenged the deal in the PNG Supreme Court. In 2005, the court ruled that certain aspects of the ECP relating to the immunity of the Australian policemen were unconstitutional. A few weeks later, Australia withdrew its policemen and decreased its ECP commitments.

Transformation Status

I. Democracy

Democratic transformation in Papua New Guinea advanced little during the period of review. Major shortcomings in democratic consolidation remain, particularly regarding political representation, free and fair elections, rule of law, the effective and efficient working of democratic institutions, and consensus-building.

1 | Stateness

There is no problem with state identity in Papua New Guinea. The state has an unrestricted monopoly on power, although tribal groups challenge the state. The Southern Highlands have been under warlord rule for much of the last three years, and a state of emergency has been declared there.

Monopoly on the use of force

Definition of citizenship is not a politically relevant issue. All citizens have the same civil rights, although many are not able to enjoy these rights due to a weak state.

State identity

There is separation of church and state, although the constitution does state that Papua New Guinea is a “Christian” country. The church remains an influential voice. 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.

No interference of religious dogmas

Although state identity is not an issue, the country suffers from an inefficient and corrupt bureaucracy, 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 to mainland Papua

Basic administration

New Guinea. The people of 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 Guinean government unveiled a new constitution for the island, granting Bougainvillians a higher degree of autonomy. Elections were held and a new provincial government was established. Nevertheless, tensions between the central government and Bougainville persist, and the United Nations maintains a presence on Bougainville.

2 | Political Participation

There is universal suffrage and elections have been held in a timely manner since independence. The next general election is scheduled for mid-2007. However, serious problems remain with regard to participation. Electoral processes are essentially free and fair, but 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, there were more than fifty deaths. Nevertheless, the transfer of power takes place peacefully after the election results are announced, and the military and the police have generally kept out of politics. Electoral corruption is rarely, if ever, driven from the center, but is nearly always the result of acute local-level competition for electoral victory.

Free and fair elections

Elected rulers have the power to govern in important matters, but their governing power can and is rendered somewhat ineffective by strong veto groups such as warlords in the southern hinterlands.

Effective power to govern

There are no problems in asserting the constitutional right to political organization, and non-governmental organizations (NGOs) play an active role in voter education and civil society. Political and civil organizations such as trade unions can and do form freely. There are many NGOs and new ones are regularly established.

Association / assembly rights

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 that women should look after

Freedom of expression

the family and the household. This belief is particularly entrenched in the Highlands, where, in some remote communities, women are extremely discriminated against.

3 | Rule of Law

There is an absence of rule of law. Transformation deficiencies exist in the system of checks and balances between the executive, legislative and judicial branches. The political executive dominates the political process. This means that the parliament has little say in political decision-making processes. 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.

Separation of powers

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 this resource problem will soon be resolved. Several new judges, including expatriate judges, have been appointed in the past two years.

Independent judiciary

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 concluded 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 withdrawal of Australian policemen under the ECP in 2005 has worsened the situation. In late 2006 and early 2007, there was serious infighting within the police force, causing the government to appoint three different police commissioners. The ultimate problem remains the issue of good governance. Corruption is endemic, and Papua New Guinea ranks at 130 in Transparency International’s 2006 Corruption Perception Index, down from rank 102 in 2004. PNG also scored poorly in the World Bank’s Worldwide Governance Indicators (1996-2005). In theory, all

Prosecution of office abuse

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 purposely-built-in 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 as 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.” All recent attempts to control corruption among the elite appear to have failed miserably.

On paper, the constitution guarantees civil rights and there are only few legal or formal restrictions on civil rights; in reality, the lamentable state of the judicial system, the weak rule of law, corruption in the administrative and judicial systems and the police, and the violations of the state’s monopoly on the use of force allow for violations of civil rights and their de facto non-implementation.

Civil rights

4 | Stability of Democratic Institutions

Despite all of these problems, democratic institutions are remarkably stable. Institutional deficiencies are mainly due to poor governance, inefficiency and corruption.

Performance of democratic institutions

All relevant political and social players accept democratic institutions and regard them as legitimate. Part of the problem is that no recent government has ever served out a full five-year term. That pattern was broken by the current incumbent government led by Michael Somare, who is the first prime minister to serve a full five-year term. By using new legislation that regulates the behavior of political parties and elected politicians, and deploying cunning political moves (such as cabinet reshuffles, instant sackings), he has managed to evade several planned votes of no confidence. The main source of instability in other key institutions can be found in the overall instability of government. Each time a new minister is appointed, there is usually a wholesale change in the affected ministry as the minister come up with new policies and modifies the old ones. Since the election of the Somare government in 2002, there were several unsuccessful attempts to unseat the highly rated Treasury and Finance Minister Bart Philemon before he was sacked in 2006 while on an official trip overseas. Similarly, several attempts were made to remove the governor of the Bank of Papua New Guinea, Wilson Kamit. The consistent economic and fiscal policy in the period under review was mainly due to Philemon and Kamit’s work. With Bart Philemon’s sacking, many are worried that economic policy may be more prone to political expediency. Philemon is widely seen as a capable technocrat with a clean record. With general elections in 2007, the government will spend lavishly to win office.

Commitment to democratic institutions

5 | Political and Social Integration

Political parties remain weak in Papua New Guinea. Political parties are seen as vehicles to realize 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 to another party under specific circumstances, such as the dissolution of the party. The idea behind the law is to make political parties more important than the individual members of parliament and thus reduce the number of “yo-yo” members who switch from party to party, based on personal benefits. Many votes of no confidence succeeded because of these “yo-yo” politicians. Six years after the passage of the integrity law, the law appears to have had partial success. A few members of parliament continue to switch parties and have challenged the law in the courts. Some parties have been divided, with some party members in government while others sit on the opposition benches. Thus far, the courts have not ruled on any of these breaches of the law.

Party system

Interest groups in Papua New Guinea are underdeveloped and highly polarized.

Interest groups

There are deep problems related to social integration in Papua New Guinea. Clan or tribe loyalties are stronger than loyalty to the state. In almost every urban center, hundreds of clan or regional associations promote clan and regional solidarity. In the highland regions, there are regular tribal wars over issues such as compensation, land boundaries and “payback” killings. Tribal war shut down the Southern Highlands province for most of 2006 and 2007. The easy availability of weapons means that the 2007 general elections will be violent. 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.

Consent to democratic norms

There is a loose web of heterogeneous social groups and organizations; however, civil society encounters numerous cultural, social and economic barriers. Social trust in society is unevenly distributed and weak in general.

Associational activities

II. Market Economy

6 | Level of Socioeconomic Development

Key indicators reveal a low level of development in Papua New Guinea. It is ranked 139th in the UNDP's Human Development Index, 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 low growth in all sectors of the economy and poor governance, especially in rural areas. Per capita GDP in Papua New Guinea was approximately \$662 in both 2005 and 2006. Despite recent positive GDP growth, Papua New Guinea's real per capita GDP remains lower than it was in 1994, reflecting an overall downward trend since 1994. The UNDP estimated that 37.5% of the population lived below the poverty line from 1990 to 2002. The country's level of socioeconomic development does not allow adequate freedom of choice for all citizens. There is evidence of social exclusion based on poverty, ethnicity, unequal access to education, and gender discrimination. Throughout the period under review, the country has not been able to reduce social disparities, poverty levels remain high and income disparity is getting worse.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	2,993	3,527	3,926	4,945
Growth of GDP	%	-0.2	2.2	2.7	3.3
Inflation (CPI)	%	11.8	14.7	2.2	1.7
Unemployment	%	-	-	-	-
Foreign direct investment	% of GDP	0.6	2.9	1.4	0.7
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ mn.	-128.7	139.6	122.2	640.4
Public debt	\$ mn.	1,479.3	1,504.5	1,445.1	1,266.4

		2002	2003	2004	2005
External debt	\$ mn.	2,477.0	2,464.0	2,149.0	1,848.8
External debt service	% of GNI	9.9	9.6	-	-
Cash surplus or deficit	% of GDP	-2.3	-	-	-
Tax Revenue	% of GDP	21	-	-	-
Government consumption	% of GDP	-	-	-	-
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	3.2	2.9	3.0	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	0.6	0.6	0.6	0.6

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | 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 an independent 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, breakdowns in 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 “facilitation money” can win a significant advantage over competitors. Commissions of inquiry have found numerous instances of public contracts 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 market 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. The

Market-based
competition

history of the privatization of Telikom PNG, the government-owned telecommunications monopoly, illustrates 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 contract in 2003. The sale of the company faced strong opposition among Telikom employees who were used to low productivity and a poor work ethic. 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 a great deal of 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, the privatization of other non-performing state assets, such as Air Niugini, has also come to a complete stop. Since 2004, the government has officially frozen the privatization policy.

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 strike. Many of them 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. This same politician has confirmed that he will run for office again in 2007 on a similar socialist platform.

Liberalization of
foreign trade

Restructuring of the financial system has continued, but with only four banks in the country, an unofficial oligarchy exists. One of the four banks, Bank South Pacific (BSP), controls more than 70% 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. Most businesses still prefer cash. While the bulk of foreign trade is conducted with Australia, 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 (FDI) due to the myriad economic and political problems in the country.

Banking system

8 | Currency and Price Stability

Monetary policy in Papua New Guinea during the review period was aimed primarily at curbing inflation. Inflation was at around 2.4% during the review period. The Central Bank also took steps to reduce interest rates and by 2007, 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. For most of 2006, the kina stabilized at around \$0.33. By the end of 2006, reserves had reached a record high PGK 4 billion (\$1.3 billion). 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. In early 2006, the central bank relaxed its foreign exchange regime. Since the mid-1990s, there were restrictions on the amount that can be remitted overseas in any one calendar year. Businesses are now allowed to remit up to PGK 250,000 without much difficulty.

Anti-inflation /
forex policy

In the period under review, the currency, prices and economic growth were relatively stable. The country underwent a severe recession in the late 1990s and only started to recover slightly in the early 2000s. In the past two years, the country achieved growth rates of approximately 3.7% in 2006 and is projected to grow by 4.4% in 2007. 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. Current economic development is based on foreign aid and a small but sustainable private sector.

Macrostability

9 | Private Property

Papua New Guinea's market economy is overwhelmingly based on private ownership. Property rights and the regulation of property are adequately defined. 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 the country is not surveyed and is deemed as customary land. It is impossible under present laws to get a title to these lands and their traditional

Property rights

owners are commonly referred to as “landowners.” Because these lands are not properly surveyed, disputes often arise over who the “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 than that of Papua New Guinea.

However, large sectors of the economy remain under government control. For example, power, 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 civil service culture, practices and mentality. All of these SOEs are saddled with debt, antiquated equipment and a workforce that is both bloated and unproductive. Although the Mourata government moved to privatize these SOEs in 2001, it 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. After several failed attempts to privatize Telekom PNG, the Somare Government announced that it no longer believes in the privatization policy.

Private
enterprise

10 | 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 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 of the owner of the house. Many cases of corruption in Papua New Guinea can often be traced to “wantokism,” or

Social safety nets

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 PGK 200 million, 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 a 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.

There are few institutions to compensate for gross social differences, especially between women and men; members of various ethnic groups in the hinterland or peripheral areas have very limited access to education and other public facilities.

Equal opportunity

11 | Economic Performance

Throughout the review period, the Papua New Guinean economy grew modestly after years of negative growth. Real GDP grew by about 3% in 2005, by 3.5% in 2006 and is estimated to grow by 4% in 2007. 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 under review; relatively high oil prices contributed to economic growth. The government is committed to making the private sector the primary engine for growth. This strategy is appropriately called the “Export-Driven Growth Strategy.”

Output strength

12 | Sustainability

Environmental concerns have grown in recent years among all sections of the population. There are many NGOs actively pursuing environmental issues, especially against timber companies. Despite a strong NGO presence, government policy has often tended to support developers. The government’s

Environmental policy

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 of 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 underdeveloped 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, underfunding and fraud means that 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 probably less than 50% and the UNDP's Education Index for PNG is 0.52. Although the government established an intellectual property office in 2002, there are virtually no commercial research and development activities in Papua New Guinea. The establishment of the intellectual property office was done more to comply with international obligations than because of any need to protect patents. There have been moves to codify traditional knowledge, but these activities lack the necessary expertise and funds for proper management.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

The level of difficulty in governing a country like Papua New Guinea cannot be underestimated. Politicians are self-serving, and almost every socioeconomic indicator has declined since independence in 1975. Poor governance, endemic corruption, the lack of 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 the country has been reported to be on “the brink of collapse” and has regularly been referred to as a failed state.

Structural
constraints

Papua New Guinea has very weak traditions of civil society. There are non-governmental organizations (NGOs) that play an active role in voter education and civil society. Political and civil organizations such as trade unions can and do form freely. However, these are of recent origin and do not constitute a rich tradition of civil society.

Civil society
traditions

Papua society and its political elite are deeply split into clans, ethnic communities, local groups or political factions. There are violent incidents and the political elite exhibits only weak elements of elite settlement.

Conflict intensity

II. Management Performance

14 | Steering Capability

The government has generally demonstrated determination in its economic reform strategy, but this has been hampered by corruption and by a non-performing bureaucracy.

Prioritization

Infighting among the parties in the ruling coalition and frequent changes in leadership positions have contributed to the country’s malaise. Government

Implementation

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. When parliament investigated the Southern Highlands provincial government in 2006, the report states that it uncovered “a jungle of corruption never seen before.”

The government is committed to democracy and a market economy in principle, but shows only limited will and capacity to learn from previous mistakes. Policies frequently remain stuck in the same routines. Policy learning rarely affects the knowledge base or cognitive framework on which policies are based.

Policy learning

15 | 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, 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 the system barely functions in others, such as education and health. Budget deficits since 2002 have been largely under control during the review period, with budget surpluses in 2005 and 2006.

Efficient use of assets

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 was to provide a degree of coordination and stop 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 from going against the wishes of the prime minister. One example was the removal of the finance secretary, the personnel management secretary and the national planning and monitoring secretary by the public service minister while the prime minister was overseas in September 2006. Such senior appointments must be made by the cabinet, but in this case, both the prime minister and the cabinet were bypassed. The other major problem is that the bureaucracy lacks the

Policy coordination

capacity to implement many cabinet decisions. Many decisions made at the cabinet level are not immediately implemented or are watered down by the time of implementation. There are many cases of foreign aid money left unused because the bureaucracy was unable to comply with the paperwork.

All strata of Papua New Guinean 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. The government's motivation and capacity to implement reforms is mixed.

Anti-corruption
policy

16 | 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 they disagree on how to implement these reforms.

Consensus on goals

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 in the public service. When reports pointed out that discipline in the armed forces and the police had collapsed, attempts to reform the armed forces were 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. In December 2006, the cabinet was forced to appoint three different police commissioners when the rank-and-file refused to accept the cabinet's nominee.

Anti-democratic veto
actors

There are positive signs for consensus-building. There seems to be universal approval of plans to revive the economy and to do something about the deteriorating law and order situation. The ECP's Australian policemen program was popular among the citizens. 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.

Cleavage / conflict
management

The political leadership often ignores civil society actors. It frequently formulates its policies autonomously.

Civil society
participation

17 | 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 of the main multilateral agencies – the European Union, the

Effective use of
support

UNDP, the International Monetary Fund, the World Bank and the Asian Development Bank – are active in the country. The United Nations maintains an observation presence in Bougainville. However, the roles played by all external actors are dwarfed by the activities of Australia, Papua New Guinea's former colonial ruler. Ausaid, Australia's foreign development aid program, maintains the largest number of personnel in PNG. Under the ECP, Australia is scheduled to inject more than PGK 2 billion into Papua New Guinea to resuscitate the entire state. On top of this money, Australia gives more than AUD \$300 million annually to Papua New Guinea. All post-independence governments see foreign aid as the key ingredient for infrastructure development.

Although relations between PNG's prime minister and Australia have fallen to their lowest point since independence, it has not seriously compromised the Ausaid program in the country. Somare has accused Australia of being a bully and acting like a colonial power.

Credibility

Papua New Guinea is active in regional politics through the Melanesia Spearhead Group (MSG) and the South Pacific Forum. Papua New Guinea is among the largest nations in the South Pacific, with Australia and New Zealand, and is the unofficial leader of the Melanesian group.

Regional cooperation

Strategic Outlook

The overall 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, the bureaucracy and the private sector, are weak. The country's low levels of social, economic and democratic development suggest that future transformation tasks will focus more on incremental measures to deepen 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 are either too weak or are hijacked by vested interests.

This is why the Australian-funded ECP program is so crucial to reform. For nearly two decades, Papua New Guinea has tried, but failed, to implement reforms. External intervention appears to offer an opportunity for the nation to recover and consolidate democracy. But with bad relations between the Somare administration and the Australian government, there is every reason to be skeptical that the ECP will succeed if Somare retains power in the 2007 general elections.

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 rein in spending. The main fiscal challenge is to ensure that the budget deficit averages less than 1% of the GDP and to allow for a gradual decline in the public debt-to-GDP ratio. The role of the minister in charge is crucial. The economic stability and fiscal discipline in the past three years was largely due to Bart Philemon, the minister of treasury and finance. His removal from the cabinet in mid-2006 has caused many to rethink the government's commitment to real reforms. Over the next year, the most important event will be the 2007 general elections. This election will be

crucial in deciding who will lead the country and which policies will be adopted. Continuity of economic and fiscal policy is essential. It is understood by all that economic growth is the best way out of the country's political and economic malaise. A major test of the incoming government will be the progress of the much-discussed PNG-Queensland gas pipeline. This project, worth an estimated \$3 billion, has been on the planning table since 1998. Some agreements were signed on long-term sales, and some preliminary engineering works have started. It is vital that these gas pipelines be completed by 2009, since some of the output of some of the major mines in PNG will slow down by then.

On the social front, the government must seriously tackle the problems of HIV/AIDS and income inequality. The HIV/AIDS epidemic has the potential to follow the African pattern, where the most productive segment of the population is being wiped out by HIV/AIDS. In major coffee plantations in the highlands, many of the workers are now HIV positive. HIV/AIDS is the now the leading cause of death at the Port Moresby General Hospital.