

Microeconomic reform in Papua New Guinea: the big challenge

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In this year's economic survey of Papua New Guinea, we look at the possibilities for reaching the forms and levels of investment necessary to raise income and employment, and thus accommodate the population growth expected over the next 25 years. By 2029, the population aged 15–29 years will have increased by around one million to 2.6 million. We look at what the present government has done to establish the conditions necessary for income and jobs growth that will satisfy these young people's expectations.

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Establishing the conditions necessary for much more rapid income and jobs growth is essentially about the microeconomic reforms needed to provide the environment for development of a competitive private sector. Whereas macroeconomic stabilisation and reform appear relatively easy to achieve in Papua New Guinea—as seen in the rapid return to macroeconomic stability in the wake of the several periods of economic instability since independence—adoption of microeconomic reforms has proven very difficult. Why? Answering this question is important because poor microeconomic policies appear to be a critical reason for Papua New Guinea's poor economic growth performance.

Here, we first examine the kinds of investment likely to provide income and employment opportunities. Then the micro-

economic reforms needed for such investment to take place are considered. We then look back over Papua New Guinea's experiences with microeconomic reform to see why it has proven so difficult. Finally, we examine what the present government has done to implement the needed reforms, looking particularly at the government's intentions with regard to microeconomic reform in the Medium-Term Development Strategy (MTDS) and the 2006 Budget.

Opportunities for rapid income and jobs growth

The development strategy followed in Papua New Guinea since independence is made up of three parts—development of mineral, oil and gas resources; assistance to manu-

facturing industry through import restrictions; and development of export cash crops through both plantations and smallholder farming. Light processing has been the industry most favoured by import restrictions, principally food processing and packaging. Protecting such activities is not highly damaging to an economy, but like all such protection it does raise costs for consumers and other businesses. These industries, moreover, are usually capital-intensive and therefore do not create much in the way of employment. But import protection of some manufacturing activities does damage other productive activities through raising costs of production: these protected industries include cement production and steel fabrication. Cement and fabricated steel are critical inputs into most forms of infrastructure and buildings and therefore raise costs of most fixed investments. It appears very difficult for non-economists to understand that granting assistance to firms through protection against imports is effectively the same thing as taxing exports and therefore cannot be a successful development strategy.

Development of Papua New Guinea's mineral and oil and gas resources has been the major preoccupation of its governments. Papua New Guinea is certainly rich in such natural resources in per capita terms, and it is desirable that they be developed, but mining is an activity that produces relatively few jobs. Moreover, it is unlikely that there will be much in the way of downstream processing of the materials extracted in Papua New Guinea as it is a highly capital-intensive activity. The key issue with respect to the extraction of non-renewable resources is what is done with the revenue retained in the country, that is, the revenues shared by the governments and the landowners. Because these natural resource assets are destroyed when mined, it is extremely important that a large share of the revenues

going to governments and landowners is used to create other assets that will generate income streams and jobs. Unfortunately, PNG governments appear to have failed in this very important function. It is difficult to point to where public assets such as physical infrastructure and social assets such as education and health have benefited from the large government revenues received from mining over the past 30 years. An extreme case of such government failure is Nauru, which exhausted nearly all of its phosphate reserves and is left with virtually no replacement assets.

Landowner revenues from mining also do not appear to have created much in the way of physical capital (in the form of businesses) or social capital (in the form of better education and health). The poor investment environment in Papua New Guinea provides little in the way of incentives for people to save and invest. Customary ownership of land is not attractive to individual private investment. If customary landowners receive mining revenues, they are more likely to invest in freehold land than in their customary-owned land. Because there is little freehold land available in Papua New Guinea, this means that the prices bid for freehold land are very high.

Like so many other mineral-rich developing countries, Papua New Guinea has suffered from the rent-seeking that accompanies the availability of large streams of resource revenues. Sala-i-Martin and Subramanian (2003) have shown that natural resources that generate easily-appropriated revenues, such as oils and minerals, can negatively affect a country's long-run growth by diminishing the quality of that country's institutions. In turn, the less effective the country's institutions, particularly its oversight institutions, the more widespread corruption is likely to be. The ease with which public officials have been able to appropriate mining and other resource revenues, such as

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from logging, appears to have contributed to the lack of development resulting from the vast mining revenues earned by governments in Papua New Guinea.

The failure of PNG governments to invest a significant share of the income generated from the sale of the non-renewable minerals assets in replacements assets was illustrated in the AusAID (1995) country report on Papua New Guinea. That report showed that, over the period 1984–94, net investment (that is, after adjusting gross investment for the consumption of fixed capital and estimates of the depletion of mineral and forestry assets) averaged less than 10 per cent of GDP and had fallen in the early 1990s to such an extent that by 1994 it had become negative, that is, net disinvestment. The point of that exercise was to illustrate how poorly the income from the depletion of natural resources had been managed.

While lasting public and private benefits from mining revenues have been so disappointing, it is very likely that investment in mining is far lower than it should be. In a sense this may be a good thing, as until mining revenues can be better managed it may be best to leave the resources in the ground. Investment in mining in Papua New Guinea is likely to be less than it should be because of the insecurity of access to land for mining companies and the undeveloped and insecure nature of infrastructure to support mining—such as transport infrastructure, pipelines and telecommunications. Capital for development of minerals resources is not a constraint, particularly for large-scale investments, as this will generally be sourced overseas.

Forest logging is also a natural resource enclave activity generating little downstream processing. The government has attempted to promote downstream processing by providing support to activities in the form of protection against imports and subsidies, but if downstream activities need government

assistance on a long-term basis—as appears to be the case—there is no good reason why these activities should receive such assistance, at the expense of consumers and taxpayers, instead of any other activities. The management regimes for logging appear highly ineffective, yielding low returns to landowners, promoting unsustainable harvesting rates, reducing biodiversity, and generating corruption (Duncan 1994). It is still an open question whether high-intensity logging of tropical forests can sustain those forests as a renewable resource. Only time will tell. It would seem wise, however, to ensure that a substantial share of the revenues from forestry is used to build replacement assets.

Many of these arguments apply to tuna fishing and processing. If it can be undertaken by domestic or foreign investors without government assistance, all well and good, but there is no economic justification for providing special assistance to either domestic or foreign interests to undertake these activities. The major problem with harvesting tuna, not only in Papua New Guinea but throughout the Pacific, is that the management regimes providing access to the resource appear to be generating over-fishing of at least some tuna species, while the Pacific countries' share of the revenue from the harvest is too small and declining. Better management regimes are required that will ensure sustainable harvests, higher and more stable returns to the Pacific countries, and reduce the high-level corruption seemingly associated with the allocation of access licences. Schemes that give fishing firms access at low rates in exchange for investing in land-based processing activities are highly undesirable—in particular, because there is no way of judging whether the country's share of the fishing revenue has been maximised (Duncan and Temu 1997).

We consider agricultural land Papua New Guinea's important natural resource, and we believe effective exploitation of this

resource will provide the best basis for rapid, sustainable income growth that is well distributed throughout society. The bulk of Papua New Guinea's population relies on agricultural land—usually held under collective ownership—for its livelihood. To improve these people's welfare, the productivity of land must be improved. The limited evidence indicates that agricultural productivity is not increasing in Papua New Guinea (Reddy and Duncan forthcoming). Increases in agricultural productivity will only come from increased capital investment, technological improvements, and greater and higher-quality individual effort. These improvements in farm inputs require security of land tenure, access to credit, good infrastructure for farmers to have access to commercial inputs and for getting their output to markets reliably and at low cost, marketing information, and research that yields new and improved crops and farming systems.

This issue of the journal includes several articles that illustrate well the various elements of the debate in Papua New Guinea over the mobilisation of land held under customary ownership. This debate is perhaps in its healthiest state, and hopefully ways to improve the mobilisation of customary-owned land will soon be agreed. Our view is that this outcome will best be achieved by the development of secure long-term leasehold of customary land that will provide individual investors the necessary incentives to put their time and capital into agriculture.

The underdevelopment of tourism in Papua New Guinea is one of the most disappointing features of the PNG economy. As argued by Duncan and Lawson (1997), Papua New Guinea has few rivals in terms of the richness of its natural resources as a basis for tourism, in the form of the diversity of its culture, the brilliance of its bird life, its wonderful coral reef environments, its topography, and its historical significance for people of many nations. Unfortunately, Papua

New Guinea has fewer tourists than even most of the tiny Pacific island countries. By comparison, Fiji had over 500,000 tourists in 2005. The blame for Papua New Guinea's poor performance in tourism can be laid at many doors, namely, concerns about personal security, health risks (malaria, infectious diseases as the result of poor sanitation, and now concerns over the rapid spread of HIV/AIDS), poor transport infrastructure, high-cost and unreliable essential services such as electricity, water, and telecommunications, and insecurity of property rights for investors in resort development.

Unlike the development of natural resources such as minerals, oil and gas, and forests, tourism in developing countries is a labour-intensive activity, involving people working in activities such as restaurants, transport, and the production of foods, as well as in the resort hotels themselves. For several of the Pacific island countries, tourism is becoming an important part of the economy. In Papua New Guinea, however, many obstacles have to be overcome to create the conditions that will lead investors and tourists to view it favourably as a tourist destination. The potential appears huge, though the problems to be overcome are also huge.

Microeconomic reforms needed

It is becoming more widely believed that, for a country to have strong, sustained economic growth that is well distributed, it must have institutions and policies that provide an encouraging environment for private sector development. The most important of such institutions are secure property rights and impartial enforcement of contracts, which in turn depend upon an independent law and justice system and the absence of discretionary interventions by politicians and bureaucrats in the enforcement of property rights and contracts. Freedom of internal and external trade is the manifestation of these basic

institutions working effectively. Free trade means the absence of discrimination of any form so that all people in a society have the opportunity to develop their capacities to the full, can save and invest without restrictions, and can exploit their ideas and energy to the full.

Microeconomic reform is essentially about reaching this preferred state. That is, the goal of microeconomic reform is to achieve secure property rights to land and other property, for people to have freedom to make contracts in the knowledge that the contracts will be honoured and enforced, for there to be no restrictions on savings and investment (domestic or foreign), the absence of government intervention in the operation of markets, only essential regulation of private sector activity, effective regulation against the establishment of monopolies, and for the private sector to undertake essential services where this can be shown to reduce the cost and/or improve the quality of the services provided.

Generally, microeconomic reform appears much more difficult to implement than macroeconomic reform because the costs of the adjustment to reforms such as trade liberalisation, privatisation, and public sector reform are obvious to the affected labour and capital and the costs are immediate while the benefits are not obvious, are widely dispersed, and occur over a long period of time. Moreover, because those adversely affected by the reforms are concentrated geographically, it is relatively easy for them to organise resistance against the reforms. However, other factors are also important in the success or failure of reforms and we discuss these below, with particular reference to Papua New Guinea.

Some of the microeconomic reform needed in Papua New Guinea has been implied in the above discussion about the development strategies adopted and the poor government management of Papua New Guinea's natural

resources. Trade policy, particularly the assistance provided to individual firms and industries, has been improving. A tariff reduction program which has been underway for some time and has been maintained in the face of pressure from firms and industries favoured under the previous regime. A few industries, however, continue to receive high levels of protection, therefore raising costs for other industries that could be more profitable and able to export more competitively in the absence of the protection.

Liberalisation of investment, for both domestic and foreign investment, has not progressed far. The World Bank's Foreign Investment Advisory Service has carried out a study of investment legislation and regulation and recommended significant changes to improve the investment climate in Papua New Guinea, but little progress has been made on this.

Factors affecting microeconomic reform

In our review of microeconomic reform experience in Papua New Guinea, we look at four areas where reform has been attempted. One of these may be considered a success, another appears to have been a failure, the third a partial success and the fourth a protracted affair. We explore the possible reasons for the different outcomes and see what lessons may be taken from this experience for future reform efforts.

Privatisation

Unlike many other developing countries, Papua New Guinea did not establish a large number of state-owned enterprises. Moreover, several of the government enterprises that were established have been privatised. Privatisation of the Papua New Guinea Banking Corporation has been among the successes. The telecommunications company,

Telikom, was to be the next major privatisation, but this was prevented in 2004 by the introduction of a private member's bill.

It is worth pointing out that the current government's policy of restructuring state-owned enterprises before privatisation contrasts with the growing international evidence that it does not pay to restructure (Guriev and Megginson 2006). Then Prime Minister Morauta's point that the nation has to choose between service and ownership is theoretically sound and empirically well supported (*The National*, 18 July 2001). The growing body of studies focusing on the welfare effects of privatisation, summarised in Guriev and Megginson (2006), show that substantial benefits accrue, especially to the lower income groups. One example cited from Argentina showed reductions in child mortality (saving about 500 young lives every year) from privatisation of water facilities (Galiani et al. 2001).

In the case of Papua New Guinea, privatisation can be seen as a mixed bag of successful and failed microeconomic reform initiatives. The packaging and marketing of the reform agenda appears to be one of the problems. The choice between ownership and service and the strong theoretical foundations and growing evidence in favour of the latter should be properly packaged and sold to the public. The main source of opposition is the rent-seeking of individuals who directly benefit from the *status quo*. Providing incentives for other sectors is one way of gaining their support or of nullifying their opposition. As Prime Minister Mekere Morauta showed by successfully privatising the Papua New Guinea Banking Corporation, despite the opposition led by students and trade unions, reformist leaders can bring about change in the face of resistance.

Public sector reform

Public sector reform has been a protracted affair in Papua New Guinea. Reform

initiatives have been trialed in every decade since the country gained independence (Kavanamur et al. 2004). The latest was the Public Sector Right-sizing initiative undertaken in 2005, but with the committee's report still confidential, and its recommendations unimplemented, the initiative seems likely to be another failure.

Public sector reform is likely to remain a protracted affair for several reasons. First, reform attempts fail to recognise it as a fiscal policy issue. Establishing the optimal fiscal capacity for the public service remains the ideal approach. Therefore, public sector reform should be complemented by comprehensive fiscal policy reforms that include a review of the country's revenue base, including tax and non-tax revenues, and donor aid and grants. Second, the small size of the private sector relative to the public sector is a disincentive for public sector reform. Under such circumstances, rent-seeking and cronyism are to be expected, particularly the allocation of public contracts to politicians' friends and relatives. Public sector reform in Papua New Guinea cannot succeed without the development of the private sector. Moreover, this development has to take place under open market conditions and not be dependent on government favours.

Third, reforms to relax the control of information by a minority of élites are difficult given the strong incentives for individuals to remain loyal to their own network. The well-connected will prefer to use the information selectively to pursue private interests. Fourth, poor packaging of the reform agenda has been another factor impeding progress. The poor implementation of the privatisation initiative and major political reforms (the provincial government reforms and creation of new electorates) has contributed to the increased size of the public sector. Fifth, the international donor community's continued emphasis on social sectors has contributed to the increasing reliance on the government sector

for post-project life. The last factor contributes significantly to the recurrent budget over time.

Land reform

Attempts to develop a formal tenure system for accessing customary land for individual activity have largely failed in Papua New Guinea (Larmour 2002, 2003). However, the debate over customary land reform continues. Historically, attempts at land reform began with a series of land settlement trials during the 1950s (Cheetham 1963; Hulme 1984; Wright 2002). The nucleus-estate farm model adopted by the oil palm industry (Christensen 1986; Grieve 1986) is a hybrid of the land settlement trials. Given the success of the nucleus-estate model, it has been adopted in the rice, cattle and chicken industries.

During the 1950s, rapid alienation of customary land for agricultural development and land settlement took place. These trials were aimed at developing indigenous agriculture.

The idea was conceived as a voluntary process for the development of private property rights over customary land. It was expected that, once successful, a settlement family's standard of living would be above that of the majority of the villager farmers. The expected change in the settler family's life was expected to stimulate demand for private property rights, which would engender a favourable attitude toward the conversion of customary land to land with formal individual titles, and expand indigenous agricultural development (Cheetham 1963). This policy was underpinned by then Territories Minister Paul Hasluck's conviction in retaining customary land under indigenous control (Wright 2002). The Commission of Inquiry into Land Matters (CILM) established in 1973 was the major pre-independence attempt to bring about land reform. The thrust of the Commission's recommendations was to revert alienated land to customary control.

The four subsequent Acts that implemented the Plantation Redistribution Scheme indicate the significance of this policy intent. These are the Land Acquisitions Act 1974, the Land Registration Act 1974, the Land Groups Act 1974, and the Land Trespass Act 1974. These Acts remain in place. There was no subsequent political interest in land reform until 1994/95, when the World Bank included land reform as one of the conditions of the structural adjustment program. A second attempt to reform customary land tenure was made in 2001 by the Morauta Government. Both attempts failed because of strong opposition from non-government organisations, students and trade unions.

Most of these attempts at land reform have been inspired intellectually by foreign sources and actors. Indigenous people, being an integral part of the matter under consideration, are more aware of the cultural context in which the issues are discussed. Achieving an appropriate balance within the diverse cultures of Papua New Guinea is a difficult task, even for indigenous people. Understanding the drivers of reform is therefore important. In that context, the Commission of Inquiry into Land Matters was introduced at a time when the country was in the mood for independence, whereas the reform attempted in 1995 occurred in the middle of a financial crisis, and was imposed by an external body, the World Bank. The 2001 attempt was introduced by a reformist prime minister but was hampered by being initiated at the end of the parliamentary term. Furthermore, the government was concurrently pushing a major privatisation program in which the largest commercial bank had just been privatised and the monopolist telecommunications company was next in line. Students and non-government organisations, riding the bandwagon of potential political candidates and losers from the privatisation program, opposed land reform.

These experiences show that sequencing of reforms, packaging of reforms, and championing and marketing of reforms are important elements of the reform process.

While the land debate has remained mainly a preoccupation of academics and a few policymakers, the mainstream national policy machinery has not committed to any land reform agenda for most of the post-independence period. However, the Minister for Lands and Physical Planning has initiated a new reform attempt that encompasses a review of land administration and land arbitration for both customary and alienated state land, and the development of customary land. The process began with the National Lands Summit in 2005 and the establishment of a National Land Development Taskforce. To increase ownership of the outcome, key PNG institutions and government departments are engaged, as are indigenous experts. The success of this reform attempt, however, is yet to be measured.

Labour market reforms

The Minimum Wages Board regulated minimum wages for most of the period from independence until 1992, setting the urban minimum wage at around three times the rural minimum wage. Adjustments were determined by a tripartite agreement involving trade unions, employer associations and the government.

This regulation spurred more rapid rural–urban migration, leading to law and order problems and high urban wage costs, both of which restricted private sector development. In 1992, the wage-setting system was reformed under pressure from the World Bank. A single national minimum wage was established by reducing the urban minimum wage to the level of the rural minimum. Direct negotiations between employers and employees were to determine wage rates above the national minimum wage. For new entrants, the minimum wage was set at 75 per cent of the national minimum.

The labour market deregulation can be seen as a successful microeconomic reform. Consideration of the factors leading to this success provides useful lessons. First, there was extensive academic analysis involved in arguing the case for reform, providing theoretical and empirical support for the reform. Second, at that time the trade union movement was disorganised (Kavanamur and Okole 2005). The reform succeeded in stimulating employment, but the general decline in economic activity at the time offset the gains (Levantis 2000). This highlights the importance of packaging reform programs for maximum impact. In that respect, complementary microeconomic reforms failed in important areas such as investment, land mobilisation, and the development of institutions to strengthen the rule of law and enforcement of justice.

Lessons from other countries

In 2002, the Global Development Network launched the ‘Understanding Reform’ project. The main purpose of the project was to increase knowledge about designing and implementing economic reforms by comparing reform experiences across developing countries. The seven thematic papers reached the following conclusions, as summarised by Fanellie and McMahon (2005).

- There is no single definite and complete blueprint for reform. An imported prescription may be misleading for those designing and implementing reforms.
- The existence of an effective state endowed with an efficient bureaucracy cannot be taken for granted. In fact, the reform process appears to be more a matter of learning-by-doing and building-while-doing. Policy ownership greatly assists.
- Understanding the political economy of the country is important. Distributive conflicts and the role of interest groups matter.

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- The reform process should be conceived as institutional change. Moreover, an institution must be considered in the general context in which it functions.
- Reforms do not occur in a political vacuum. The polity is the source of the rule of law and governance. Political and economic reforms therefore coexist.

These lessons from the Understanding Reform project provide useful insights and support for the above analysis of the experience with microeconomic reform in Papua New Guinea. The overall message is that there is no magic formula. Each country must develop its own reform agenda.

The Somare government's microeconomic reform efforts

The current Somare Government has experienced a period of political stability not seen for many years in Papua New Guinea. Good government-expenditure control, together with the increased revenues from the high prices for petroleum and gold, has provided scope for the government to reduce the public debt substantially. When the government took office the public debt/GDP ratio was over 70 per cent, but is expected to fall to 50 per cent by the end of 2005. The budget surplus, low interest rates, low inflation, and the high level of foreign exchange reserves reflect improved macroeconomic management, which should provide an encouraging environment for investment. However, the rapid growth in investment and the kind of investment needed for rapid and widely distributed income growth has not been forthcoming. The economy has barely achieved a growth rate of real GDP equal to population growth. The government's inability to improve the investment climate basically derives from the ongoing minerals sector-led development strategy and an incapacity or unwillingness

to implement the necessary changes in microeconomic institutions and policies.

In August 2002, the Somare Government established the Program for Recovery and Development (PRD). The intention of the Medium Term Development Strategy (MTDS) 2003–07 (which was drafted but not implemented) and later the MTDS 2005–10 was to put the PRD into operation. The PRD has three broad-based objectives: good governance, export-driven economic growth, and rural development, poverty alleviation and empowerment through human resource development. The expenditure priorities during the life of the MTDS 2005–10 are set down as

- rehabilitation and maintenance of transport infrastructure
- promotion of income-earning opportunities
- basic education
- development-oriented informal adult education
- primary health care
- HIV-AIDS prevention
- law and justice.

The government has since launched the Green Revolution package under the PRD, which included increased subsidies for agricultural inputs. Major incentives have also been introduced to stimulate investment in the mining and petroleum sector. These two examples show that the government is still fixated by the idea of minerals-led development, with compensation for import-substituting and other export sectors. The allocation of 400 million kina in the 2006 Budget to the PNG–Australia gas pipeline project as an equity contribution supports this assertion. The government's use of increased revenues from the mining sector to reduce public debt does indicate an appreciation of the need for better management of these revenues and avoidance of rent-seeking claims to the funds. The reinvestment of a large

share of these funds in the mining sector rather than into the building of replacement assets, however, suggests only partial understanding of the kind of management needed.

A review of the MTDS (Mawuli et al. 2005) revealed serious shortcomings. One was the government's selection of priority areas. The priority areas chosen constitute a small component of large sectors. For instance, primary health care is a small component of the large health sector. In an effort to implement the MTDS, up to 55 per cent of the development budget has been earmarked for these priority areas.

The MTDS does not show any recognition of the importance of microeconomic reform. Sweeping statements are made about land (section 1.6), public sector reform (Chapter 5), trade (section 1.4), investment (section 3.3), privatisation (section 5.2.1) and credit (section 3.2.2). However, there is no discussion of the kinds of reforms that need to be undertaken to achieve better performance in these areas in the 2006 National Budget. There seems to be no concern that a disproportionate share of the annual budget will be allocated to the MTDS priority programs during the life of the MTDS.

Likewise, the 2006 Budget ignores major microeconomic reforms. While trade and investment liberalisation are recognised, other major areas are not. In the Budget Speech, the Minister for Finance and Treasury said that the final phase of the current tariff reform program would be implemented in 2006, with tariffs on a range of goods being reduced by five percentage points and tariffs reduced on a range of goods that are not produced in Papua New Guinea. Further, the government, rather worryingly, announced that there would be a comprehensive review of tariff structures during 2006, even though a major review of the tariff reform program was carried out only two years ago. Protected industries continue, however, to agitate for reversal of the tariff

reform program. Having gone this far with tariff liberalisation, with only a few industries still receiving high protection, a government strongly committed to trade liberalisation would surely find it unnecessary to hold another extensive inquiry. The government should simply go ahead and remove the remaining tariffs. Another inquiry will only provide an opportunity for vested interests to push for renewed special treatment.

In the Budget Speech, the Treasurer also promised that the government would continue implementing the FIAS recommendations for improvements in the legislative environment for investment. Progress on this front has been very slow. Hopefully, the 'red tape' of regulation can also be substantially reduced so that the processes involved in setting up businesses can be substantially simplified.

On the provision of utility services, the Treasurer announced that 'government will also look at options to improve the service provided to consumers by utility providers' (Papua New Guinea 2005:n.p.). This statement appears to indicate a very half-hearted commitment to reform in this important area. Several surveys of private firms undertaken by the Institute of National Affairs and also the business-cost survey by Duncan and Lawson (1997) found that the high cost and unreliability of utility services is one of Papua New Guinea's most pressing concerns. If the government is serious about establishing an investor-friendly environment, it must focus on reform in this area.

Tax incentives aimed at boosting investment in the tourism industry, including double deductions for advertising expenses and accelerated depreciation provisions for capital expenditures on tourist facilities, were also announced in the budget. Despite many studies demonstrating that tax relief is a minimal influence in investors' consideration of investment possibilities across countries, governments persist in going down this path. Such actions do not address any of the obstacles noted earlier to

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the development of tourism in Papua New Guinea. For agriculture, the budget again focuses on providing tax incentives for investment. More than anything, these policies signify a 'policy vacuum', an inability to come to grips with the obstacles to development of these very important areas of the economy. No doubt the rural areas will welcome the promised improvement in public services to be delivered through the District Services Improvement Program, which is an attempt to improve security, medical, postal, telecommunication, water, and other services gradually. On public sector reform more generally, while the budget mentioned the Public Sector Right-sizing Committee report and made broad statements about the conclusions, it did not elaborate on the implementation of the committee's recommendations.

According to the Treasurer's 2006 Budget presentation, the government recognises that the private sector is the engine of economic growth and that it 'is still not growing fast enough to provide the income earning opportunities that are needed' (Papua New Guinea 2005:n.p.). But, out of a total 25 pages, the Treasurer's devotes only one to general statements about public sector reform and one other to microeconomic reforms such as improving the investment environment and regulatory control by the Independent Consumer and Competition Commission over telecommunications and coastal shipping. The themes in the Program for Recovery and Development, the Medium-Term Development Strategy, and the 2006 Budget indicate either ignorance of the importance of microeconomic reform or an unwillingness to entertain needed reforms due to the influence of those benefiting from the *status quo*. It is difficult to distinguish between these two possibilities. But, if the microeconomic foundations for sustained economic growth are not emphasised and implemented, gains from the recent short period of macroeconomic stability and modest growth will disappear

into thin air. This government, which has almost served a full term of five years, appears to have lost a golden opportunity to build the microeconomic foundations for sustained economic growth and development.

Conclusions

The tensions and problems arising from rapid population growth will only intensify in Papua New Guinea, with the number of people in the 15–29 year age old group increasing by about 1 million over the next 25 years. Governments therefore face an unenviable task in trying to create an environment for rapid growth in investment that will provide the job opportunities that these young people will increasingly expect. The current government has done an excellent job in achieving good macroeconomic policy and outcomes, but over the years this has proven to be a relatively easy task in Papua New Guinea. The really difficult task, one that most governments have been unwilling to face, is developing microeconomic institutions and policies that promote the private sector, the engine of economic growth.

Like earlier governments, the current government has been fixated on a mining-led development strategy. The management of the large revenue flows from mining has been poor, however, with little to show in the form of replacement assets for the depleted mineral resources. If management of these revenue flows cannot be improved, it may be best to leave the resources in the ground. Appropriately, the current government has used some of the increased revenues from the recent high mineral and petroleum prices to pay down a substantial part of the public debt, although there is still quite a way to go to reach what is considered to be a prudential debt/GDP ratio. Still, there is little indication that the government is aware of the need for a different development strategy and for

reducing the reliance on mining. The agricultural sector and tourism would seem to be the areas on which to base rapid, sustainable economic growth that is widely distributed. However, significant development of these sectors requires microeconomic reform in several areas.

This review has shown that microeconomic reform is possible in Papua New Guinea if it is based on sound theoretical and empirical foundations, adequately recognises the political and cultural context, has a political 'champion' who promotes ownership of the reforms through public education, and there is appropriate packaging and sequencing of the reforms. Extensive policy discussion is not easily translated into policy, law and implementation. This has been particularly true for the land reform debate. The timing, packaging and marketing of the reform are important. There is no external blueprint to follow. Papua New Guinea must therefore decide on its long-term goals and strategies and initiate microeconomic reforms that will provide the foundation for sustained economic growth and development.

Unfortunately, the current government has so far shown little inclination to become fully engaged with the necessary microeconomic reforms. It appears uncertain about completing the trade liberalisation reform program and half-hearted about reforming essential services and the public sector. It seems bereft of ideas for the crucial agricultural and tourism sectors, resorting in the budget to the disproved mechanism of tax incentives. One area of hope is land reform, where the maturity of the debate over the issue of mobilisation of customary-owned land has been encouraging. The challenge, of course, will be transforming recommendations and debate into legislation and action.

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