BUSINESS DEVELOPMENT IN PAPUA NEW GUINEA

Opportunities and Impediments to Private Sector Investment and Development In Papua New Guinea

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Executive Summary

Papua New Guinea's economy has the potential to be a vital, thriving entity based on mineral, agricultural and marine commodities and supplemented by tourism. Instead, Papua New Guinea is mired in economic stagnation, with a dysfunctional business environment where few industries survive. The continued dysfunction of the business sector, and the resulting paucity of economic development, is constraining Papua New Guinea's ability to "trade its way" out of poverty. Business activity is an essential foundation of international trade, and trade is increasingly a focus in poverty alleviation programs. Historically, the resource extractive industries have proven to be the most profitable of those businesses in Papua New Guinea, bringing with them a host of financial and social problems, not least of those the perils of Dutch disease. Papua New Guinea has thus far failed to capitalize on these revenues and business activity outside the resource extractive sector is limited.

This study focuses on the small-to-medium manufacturing and value-adding sector, and is the result of focused interviews with the mangers of eight Papua New Guinea based businesses. It is complemented by interviews with managers of several statutory bodies, business councils and research centres. While it covers a range of industries, there are common themes that emerge quickly: a lack of policy stability which makes long-term business planning nearly impossible; continual problems with logistics and the bureaucracy surrounding it; irregular application of tariffs and taxes, exacerbated by opportunities for corruption; and a lack of appropriately qualified staff, particularly skilled tradespeople, a problem which becomes more pressing during a mining boom. Business in Papua New Guinea is stagnant: business people have few plans for expansion, and those that do require political support to facilitate their plans for expanded land usage. Land title per se is not the major issue: rather, a lack of adequate enforcement of existing rights and contracts is making efficient land usage difficult, if not impossible, for many business owners.

Interestingly, safety and security is less of an issue for these business people than prior work might suggest. Most commented that security was a business cost that could be planned for and mitigated with reasonable success. Many of the highly risky activities involved in these businesses were sub-contracted to indigenous Papua New Guineans, and the most disruptive security issues are concentrated in those working with highlands producers. The most significant impacts of law and order were secondary: several managers commented on the great expense involved in recruiting staff from Australia, and one commented on the difficulty of raising funds in Australia. It appears that the media coverage of the dangers of Papua New Guinea has given perhaps an overly pessimistic view of the situation and has served to actively discourage employment and investment.

While law and order problems may act as a disincentive for those in Australia, it has not served to discourage Asian investors who are actively involved in many industries, particularly fishing and fish processing, and who are among the few business investors planning to expand their operations. Already a significant participant in business activities, Asia looks set to become Papua New Guinea's key partner in trade and investment over the coming decades. A focus on growth and integration with Asian markets will provide opportunities for export-led development.

Papua New Guinea has a history of encouraging medium-sized enterprises into the country under special circumstances: granting them monopolies, having them take advantage of preferential arrangements for trade provided by the European Union. This has resulted in problems before, and it is likely that the erosion of trade preferences which is the likely outcome of the Doha round will have a serious impact on the viability of the tuna export industry. The way in which this is managed will have long-term ramifications for Papua New Guinea. A successful transition away from preferences will result in a stable and profitable sector for future development: however, if this is not managed adequately, the loss of preferences may compound existing constraints and result in the loss of this industry.

The outlook for the next few years is promising. Currency devaluation has made wages more competitive with neighbouring economies than in the past, and has stimulated import substitution and made some domestically produced products more competitive. Mining revenues are expected to improve the Government of Papua New Guinea's fiscal position, and give the Government an opportunity to implement reform programs and plan more strategically for business development. This report recommends action in the following areas:

1. A thorough reassessment of the regulatory environment, business licensing laws and the structure of statutory bodies: the development of leaner, more responsive and less politically influenced bodies will immediately assist business development. Fewer bureaucratic regulations and procedures save public service funds, eliminate avenues for corruption and lower compliance costs for business.

2. The articulation and promotion of a cohesive business development plan, including the development of an efficient logistics infrastructure and a pool of technically skilled workers and which minimizes bureaucratic red tape and opportunities for corruption, to support the Medium-Term Development Strategy.

3. A focused approach to the development of business centres with core competencies, well-trained skilled and semi-skilled labour and supporting infrastructure will assist in promulgating the export-led growth scenario which forms the first plank of the Medium-Term Development Strategy.

4. Policy-directed research, which may be used as the foundations of business-enabling strategies, is currently lacking, yet is much needed if successful reforms are to be initiated and implemented.

The immediate future represents an opportunity for Papua New Guinea to move forward: whether this promise can be fulfilled will depend on the determination of the Government and its people.

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1. Introduction

Papua New Guinea's economy has the potential to be a vital, thriving entity based on mineral, agricultural and marine commodities and supplemented by tourism. Instead, Papua New Guinea is mired in economic stagnation, with a dysfunctional business environment where few major industries survive. The mining sector (and services to the mining sector) remains the only area where significant activity takes place - this activity is cyclical and depends to a large part on international commodity prices. The agricultural sector, despite years of development activity, remains sluggish and has failed to provide significant quality of life improvements to most participants. Other industry sectors are small, with only a handful of firms competing in each and the vast majority of these are at least partly foreign owned and managed.

The continued dysfunction of the business sector, and the resulting paucity of economic development, is consistent with current thinking in development circles. Business activity is an essential component of international trade, and trade is increasingly a focus in poverty alleviation programs. Without a vibrant formal business environment which allows entrepreneurs to develop domestic industry and export to the world, it is unlikely that other poverty alleviation interventions will have sustainable impacts. Evidence from Asian countries that have successfully alleviated poverty indicates that "[t]he secret of poverty reducing growth lies in creating business opportunities for domestic investors, including the poor, through institutional innovations that are tailored to local political and institutional realities" (Birdsall, Rodrik and Subramanian, 2005, p. 146). Unfortunately, Papua New Guinea has perhaps been too successful in tailoring most business development initiatives to local institutional realities, resulting in a business environment that is corrupt, unstable and unable to plan for the future.

Donors and development organizations recognize the importance of a thriving business sector and there is a general acceptance that markets can work efficiently to promote growth when allowed to operate seamlessly within a supportive cultural and legal framework. International development focus is increasingly on initiatives that facilitate markets to provide the environment that allows businesses to operate, and thereby assist in poverty reduction by providing jobs and income (White, 2004). Development agencies recognize that a number of conditions are required for markets to function and businesses to develop, which may include but is not limited to:

- Macroeconomic stability
- Well-defined property rights
- A sound judicial and contracting system
- A reasonable level of certainty about government policy
- Functioning financial institutions
- Good physical infrastructure, such as transport systems and ports

(World Bank, 1999)

Papua New Guinea is fortunate that some of these conditions already exist within its borders. The financial system functions comparatively well, with a number of major international banks present and numerous microfinance initiatives underway. The judicial system is generally regarded to be under-resourced (Pitt, 2001), but the foundations of an effective legal infrastructure are in place and donor programs exist in these areas. Physical infrastructure, in the form of the Highlands Highway, a national air system and the ports of Lae and Moresby, are present, although in constant need of improvement and again the focus of much donor activity. The other three conditions – policy certainty, functioning institutions and good physical infrastructure - are perhaps the most lacking in Papua New Guinea, and unfortunately these are the areas that are in many ways the most difficult to address.

Much work has been done at a bureaucratic level with the Government of Papua New Guinea to improve macroeconomic stability, and the country has seen significant improvement in fiscal management over the last three years. Inflation has been greatly reduced, and government debt has been brought under control. Property rights are a perennial issue in Melanesia generally, and substantial work is being done to address and reform these – this report will not focus on these two issues. Instead, a major focus of this report is on government policy and its impact on business enterprise. It is here where the potential for reform is greatest, and is perhaps least difficult. However, little has been done to address this to date, and it appears that lack of certainty in the business environment is one of the greatest inhibitors to business activity that exists in Papua New Guinea.

While numerous constraints are a feature of existence in PNG – law and order problems, poor electrical and communications infrastructure, corruption – these are features of many emerging markets and fail to explain why business thrives in countries experiencing similar constraints, such as the Philippines and Indonesia. The Philippines is particularly notable: regarded by many risk assessment agencies to be far more problematic than Papua New Guinea, it is fast becoming a significant source of foreign investment in Papua New Guinea in the fishing and canning industries. The Philippines and Mexico are regularly nominated as more dangerous countries in which to do business than Papua New Guinea, as are many Central and South American countries such as Colombia. In short, many of the issues generally thought to be hindering business development in Papua New Guinea only partly explain the economic stagnation of Papua New Guinea.

This report is the outcome of a series of interviews conducted during 2004-2005 as part of an AusAID funded postdoctoral fellowship. It canvasses a range of those with an interest in the Papua New Guinea business sector including bureaucrats, leaders of statutory authorities, consultants and researchers and business leaders themselves. The interview methodology used in this study has made it possible to “drill down” into the issues facing businesses in PNG today. There have been many changes in the business environment since the late 1990s – improved macroeconomic stability, law and justice reform and fiscal reforms are being successfully implemented and are appreciated by all in the business community. There is a general sense that things are improving, although it is cautious optimism as many in the business community, particularly the expatriate community, believe they have “seen it all before” and will reserve their judgments on the effectiveness of these initiatives until they see more permanent evidence of change. However, the climate is generally positive and should therefore be conducive to business. Despite this, there seems to be little change in business behaviours. Few businesses were talking of expanding, and those business people starting new enterprises were typically those for whom entrepreneurial activities were a permanent feature of their business. Other new enterprises were commencing simply because previous activities had ceased to be economically viable. The overwhelming concern for members of the business community is the lack of stability in policy and regulatory environment that means they are unable to plan or be certain about the future of their industries. While a degree of uncertainty is inherent in every business, in Papua New Guinea it is disruptive and debilitating. It is stopping businesses from expanding, and it is constraining the development of new industries. Until a modicum of certainty is introduced, it is unlikely that Papua New Guinea will be able to develop a more significant business community.

There is evidence that the Government and statutory authorities appreciate the constraints in which they must operate in order not to stifle the growth of business development services and generally undermine market operation. The Small Business Development Corporation has moved from a model of providing services to small business to one of facilitating access to private service providers, and now sees its role as facilitation rather than service provision (Kiap Komun, 2005). Such initiatives are in line with international best practice, which emphasizes the role of government and agencies in facilitating markets while avoiding entering them (White, 2004). Business environment reforms is also recognized as a fundamental and important area for government and agency participation, and it is on business environment reform that this report focuses. It is the contention of this report that such reforms are likely to produce the most effective outcomes for the business community, and that they come at little cost to both the Government of Papua New Guinea and donor and other agencies. What is needed, however, is political will and the motivation to implement lasting change.

There are myriad opportunities for business policy reform in Papua New Guinea. Those focused upon in this report are those most consistently cited by the business community as impediments to their activities. Over-regulation is a feature of the business environment, as are a plurality of badly administered and regularly changing policies regarding tariffs, exemptions and assistance. Standardization would bring not only economies of scale and reduced administrative overheads within the public service, but it would eliminate many opportunities for corruption, reduce the costs to business of adhering to these regulations and provide a more certain operating environment. A focused and cohesive business development strategy, focused on the core trading locations of Port Moresby, Lae and Madang and which aims to enhance the interconnections between each and the global trading environment, would be of obvious immediate benefit. The development of a core of effective centres of trade, with a population of skilled tradespeople, robust industries and effective infrastructure would be an excellent target for the Government of Papua New Guinea and assist in meeting the objectives of the Medium-term Development Strategy. This would provide Papua New Guinea with a sound base from which to grow its businesses.

This paper provides a discussion of policy ideas which would assist in such a strategy.

2. Country Background

Papua New Guinea is a country rich in resources and poor in human development. With a surface area of 462,800 square kilometers and a population of 5.9 million (DFAT, 2004), it is a large landmass with a small but rapidly growing citizenry. While currently Papua New Guinea is classified as a "small state" by the World Bank, with a population of under 10 million, if population growth (currently 2.5% per annum) continues, this classification will be obsolete by 2031. 41% of the population is aged under 15. The majority of the population is engaged in agriculture and in the informal sector, with 87% of the population living in rural areas[1]. The environment is rugged and many communities live in isolated circumstances due to difficult terrain and poor infrastructure. Most inhabitants believe that life has worsened since independence from Australia in 1975 (ADB, 2002), resulting in a surprising level of support for the former colonial power, despite the intense nationalism that is often used to muster support for various political parties.

An indisputable victim of Dutch disease, the economy is heavily reliant on mineral exports (gold, copper and crude oil comprising approximately 75.3% of exports by value in 2003[2]) and the economy has generally not progressed beyond a commodity base. Much of the population survives on subsistence agriculture supplemented by small cash incomes from informal sector activities. Unlike the developing economies of Africa, poverty in Papua New Guinea is not characterised by a shortage of food. Poverty in Papua New Guinea is described instead as a lack of employment/cash, land, education, basic infrastructure (including water supply, health, transportation and communication) as well as a fear of crime and a breakdown of the family unit[3].

Economic growth has effectively bypassed Papua New Guinea since independence, despite commodity booms, technology improvements, positive global conditions and donor activity. The World Bank (2000) notes that, despite extensive technical assistance, there was little progress in development outcomes during the 1990s. Fiscal mismanagement and a series of conflicts around mining resources saw investors increasingly wary of entering Papua New Guinea, and foreign investment inflows as a percentage of GDP fell to a post-independence low of only 0.6% in 1997[4]. Despite donor encouragement, few reforms took place during the 1990s, and those that were instigated were often rapidly reversed as continued political instability resulted in incentives being poorly aligned with the majority of the population. As Reilly (2002) observes, "more stable … political parties have greater capacity for translating public preferences into coherent government policy, with direct consequences for economic performance and development"[5]. This capacity was evidently lacking during the 1990s.

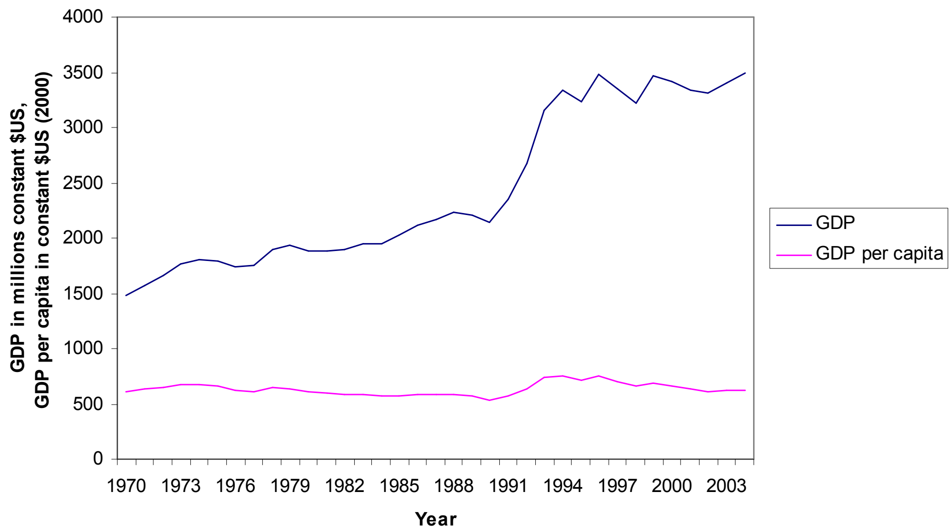
[I]nadequate political will to implement the development agenda constrained progress. Some policy initiatives and projects begun due to the influence of the Bank or other donors were not fully implemented, subsequently reversed, or allowed to lapse. To some extent, periodic surges in mineral revenues relieved the pressure to reform.

World Bank Papua New Guinea Country Assistance Evaluation, 2000:9

[1] DFAT, 2004
[2] BPNG Quarterly Economic Bulletin Statistical Tables
[3] ADB, 2002
[4] World Bank Development Indicators, 2005
[5] Reilly, 2002, p. 136

While real GDP experienced some growth between 1970 and 1994, this directly affected very little of the population. Real GDP per capita has remained stagnant since independence (Figure 1), partly a result of a lack of economic progress and partly due to a rapidly increasing population, which has risen 132% in the last 34 years.

Figure 1: Real GDP and GDP Per Capita 1970 - 2004



Source: World Bank Development Indicators 2005

The growing population is already testing the adequacy of subsistence resources, particularly when there is competition with commercial activities. Residents of costal areas engaged in subsistence fishing commented on the depletion of marine resources, perceived by some to be a result of increased commercial fishing activity and by others simply as a result of population pressures. Migration from rural to urban areas in search of better livelihoods and services has seen increased competition for infrequently maintained resources, and this is creating tensions throughout increasingly fragmented communities. Rural communities are disadvantaged throughout Papua New Guinea, particularly due to poor infrastructure development and geographic isolation. The lack of roads hinders participation in both the formal and informal economies, and poor health service provision has seen a decline in health standards in many areas. Surveys find many inhabitants of rural Papua New Guinea pessimistic about the future.

"We do not think our situation will change because we have lived this way… since Independence."

Marawakan villager, UNDP Papua New Guinea Human Development Report, 1998.

While the 1990s were regarded by some as a lost decade, there is increasing optimism about the future. Electoral reform has resulted in a more stable government, and bureaucratic reform is beginning. The Government of Papua New Guinea, under Sir Michael Somare, has welcomed donor assistance and is attempting to create an environment more receptive to business. The Medium Term Development Strategy (Government of Papua New Guinea, 2004) has placed economic development firmly on the agenda, and the development of export markets at the fore. While employment in the formal sector is limited, and there are still fewer jobs than qualified tertiary graduates, there is cause for optimism about activity in the business sector (both formal and informal). Public service employment has declined as a percentage of wage and salary earners (Table 1). These figures demonstrate an increase in the percentage of the population engaged in non-subsistence business activities for at least part of their income, and indicates a business environment that is struggling, but not completely stagnant.

Table 1: Employment Statistics, 1980 - 2000

	1980	1990	2000
Total population	2,978,057	3,582,333	5,171,548
Number of wage and salary earners employed, male	441,233	912,124	1,203,233
Number of wage and salary earners employed, female	291,573	670,394	1,141,501
Total wage and salary earners	732,806	1,582,518	2,344,734
Total wage and salary earners as a percentage of total population	24.61%	44.18%	45.34%
Total public service (maximum, estimate) [1]	50,000	65,000	75,000
Public service as a percentage of wage and salary earners	6.82%	4.11%	3.20%

[1] Several sources cite an estimate the size of the public service in 2000 as 75,000. See for example Windybank and Manning, 2003. Other figures are author's estimates.

Source: National Statistics Office Census, Papua New Guinea

Surprisingly, Papua New Guinea is included in the top 50% of 155 countries surveyed in the World Bank *Doing Business* surveys. At number 64 in 2005, it beat neighbouring business locations such as Indonesia (115), the Philippines (113) and Vietnam (99). Disturbingly, the Solomon Islands are ranked higher at 53, and Kiribati at 45, casting some doubt on the usefulness of the measures employed in the survey, as while there may have fewer business regulations, business is far from thriving in either country. Regardless, it is interesting to examine the ratings of Indonesia, Australia and Papua New Guinea, as it does serve to highlight areas in which reform may be beneficial (

Table 2).

The Government of Papua New Guinea, overseas donors and agencies have been working recently to facilitate market development in PNG. The role of small-to-medium enterprise in the business sector as a whole is appreciated, and there has been a recent focus on the informal sector that has seen reforms designed to increase small business activity (Eugenio, 2001; Institute of National Affairs, 2003). Care must be taken, however, in ensuring there are adequate pathways for business to progress from the informal sector to the formal sector. The informal sector, while a major source of income for many living in poor countries, does not provide the safety, income security and basic protections that the formal sector may provide. It creates market distortions, that may disadvantage formal sector participants, and it deprives the government of revenue. There is growing concern among development practitioners that a growing informal economy creates negative development outcomes (Palmade, 2005). While moves to open the informal sector are welcome, it is the formal sector that ultimately provides the greatest paths to stability and security for the majority of Papua New Guineans.

Table 2: Business Environment Indicators

		Papua New Guinea	Indonesia	Australia
GNI ($US per capita)		510	1,140	26,900
Overall Rating		64	115	6
Starting a Business	Number of procedures	8	12	2
	Time (days)	56	151	2
	Cost (% of income per capita)	30.2	107.1	1.9
	Minimum capital (% of income per capita)	0	97.8	0.0
	Overall Rank (of 155 countries)	60	144	2
Dealing with Licenses	Number of procedures	20	19	16
	Time (days)	218	224	121
	Cost (% of income per capita)	124.7	364.9	12.3
	Overall Rank (of 155 countries)	84	107	12
Hiring and Firing	Difficulty of hiring (index)	22	61	0
	Rigidity of hours (index)	20	40	40
	Difficulty of firing (index)	20	70	10
	Rigidity of employment (index)	21	57	17
	Hiring cost (% of salary)	7.7	10.2	21
	Firing costs (weekly)	38.4	144.8	4
	Overall Rank (of 155 countries)	32	120	14
Registering Property	Number of procedures	4	7	5
	Time (days)	72	42	5
	Cost (% of property value)	5.2	11.0	7.1
	Overall Rank (of 155 countries)	59	107	34
Getting Credit	Legal rights (index)	6	5	9
	Credit information (index)	0	3	5
	Public registry coverage (% of adults)	0	0	0
	Private bureau coverage (% of adults)	0	0.1	100.0
	Overall Rank (of 155 countries)	98	63	3
Protecting Investors	Disclosure (index)	5	8	8
	Director liability (index)	5	5	2
	Shareholder suits (index)	8	3	8
	Investor protection (index)	6.0	5.3	6.0
	Overall Rank (of 155 countries)	31	58	26
Paying Taxes	Payments (number)	43	52	12
	Time (hours)	198	560	107
	Total tax payable (% of gross profit)	36.7	38.8	37.0
	Overall Rank (of 155 countries)	60	118	14
Trading Across Borders	Documents for export (number)	5	7	5
	Signatures for export (number)	5	3	2
	Time for export (days)	30	25	12
	Documents for import (number)	10	10	11
	Signatures for import (number)	6	6	2
	Time for import (days)	32	30	16
	Overall Rank (of 155 countries)	47	49	22
Enforcing Contracts	Number of procedures	22	34	11
	Time (days)	440	570	157
	Cost (% of debt)	110.3	126.5	14.4
	Overall Rank (of 155 countries)	105	145	12
Closing a Business	Time of insolvency (years)	2.8	5.5	1.0
	Cost of insolvency (% of estate)	38.0	18.0	8.0
	Recovery rate (cents in dollar)	13.1	13.1	80.0
	Overall Rank (of 155 countries)	117	116	15

Source: World Development Bank Doing Business database, 2005

The outlook for the next few years is promising. Official inflation is low, and quarterly changes have been below 2% since June 2003[6], possibly a result of the Bank of Papua New Guinea following an “inflation targeting lite” management strategy (Bowman, 2005). Currency devaluation has made wages more competitive with neighbouring economies than was the case previously, has stimulated import substitution and has made some domestically produced goods more cost-competitive. Mining revenues are expected to improve the Government of Papua New Guinea’s fiscal position, and give the Government an opportunity to implement reform programs. This positive macroeconomic climate provides an excellent opportunity for Papua New Guinea to make real progress on the development of a vibrant business environment and to implement significant regulatory reform and restructuring.

[6] Bank of Papua New Guinea, Consumer Price Index.

3. Methodology

This research was undertaken as part of an AusAID funded postdoctoral position within the Pacific Policy Project of the Asia Pacific School of Economics and Government at the Australian National University.

This report consists of research material compiled as a desk study, and is supplemented with interviews taken from field trips. The aim of this is to provide a research-based, "philosophical" background for the case studies and examples used to substantiate the information in this report.

Two field trips were taken during the course of this research. The first comprised 5 days during October 2004 in Port Moresby, and was essentially a scoping study. During this time, a number of invaluable contacts were made within both business and government. The second field trip comprised 23 days in May 2005 and included Port Moresby, Lae, Madang, Kavieng and Hoskins. This trip encompassed the major costal business centres, and included a wide range of private industries.

The focus of this study is on industries involved in export development, and those with substantial foreign investor holdings. A decision has also been made to avoid mining and forestry industries, which already have a high profile and well-developed bodies of research. Instead, this study focuses on the manufacturing and value-adding industries, which are typically based in the small-to-medium enterprise (SME) sector. Eight companies were studied, all of which are domiciled within Papua New Guinea, and all of which had substantial holdings by foreign investors - from Malaysia (New Britain Palm Oil), Australia (KK Kingston, Bismark Barramundi, Niugini Coffee Tea and Spices, Arnotts Biscuits, James Barnes), and the Philippines (RD Cannery) and China (Neptune Fishery). Only four of the companies surveyed were primarily servicing a domestic market: KK Kingston (plastics manufacturing and packaging), Bismark Barramundi (fish farming), James Barnes PNG Ltd (food processing and canning) and Arnotts (biscuits and other foodstuffs). All exported to some degree to the surrounding market in the Pacific, Asia and Australia.

Additional discussions were held with various other researchers, consultants and those working within statuatory bodies and government agencies. These include the Small Business Development Corporation and the Investment Promotion Authority; the Manufacturers Council of Papua New Guinea; the Institute of National Affairs; the National Fisheries College in Kavieng, the University of Papua New Guinea, the Australian National University and the University of Technology, Sydney; the Madang Provincial Government; AusAID and the Department of Foreign Affairs and Trade (Australia); the International Monetary Fund; and Bismark Ramu.

When appropriate, quotes will be directly attributed to managers. However, several expressed a wish for more openly critical comments to be censored as they "did not want trouble". Accordingly, discretion has been taken as to when to attribute a quote and when to broadly allude to interviewees.

4. Major Themes – Constraints and Opportunities

Development activities in Papua New Guinea have traditionally focused on the triumvirate of health, law and order and corruption. While these are undoubtably the most pressing problems within PNG, and are problems that affect every inhabitant of the country, they are almost intractable problems in themselves without a functioning business environment that can provide employment opportunities and give people the ability to access services that can improve their wellbeing.

Access to jobs is a priority for most poor communities (ADB, 2002, p. 15), and the lack of jobs, and the lack of formal opportunities for entrepreneurship and employment, is reflected in the entrepreneurial initiatives undertaken by many New Guinea youth. The rise of crime in Papua New Guinea is not least due to the attractive incomes available from crime. Levantis (2000) observes that youth are choosing crime as the incomes available are greater than those the legal economy. Effectively, crime has become a serious career option for many young people. Gangs of "raskols" can be cynically described as entrepreneurial franchises specializing in income redistribution. If no attractive alternatives are available, it is rational for youth to enter the market for crime in order to maximize their incomes.

Further, if Papua New Guinea is to escape governance problems associated with Dutch disease, it needs a functioning economy outside the resource-intensive industries of forestry and mining. As development organizations have become more cognizant of the role of business in development, a greater focus on the development of a functioning business environment has become evident. Organisations such as the World Bank's International Finance Corporation (IFC) have become active in promoting initiatives aimed at developing the business environment in the Pacific and Papua New Guinea, as well as in other less developed countries.

The common theme among business owners and managers is the constantly shifting sands of the business environment. While other studies have indicated that bigger picture problems such as law and order and corruption were the greatest disincentives to business, these issues were not nominated as the most significant impediments to business by those interviewed for this study. Instead, the policy and regulatory environment was constantly nominated as the major problem for business. Lucas Michael, Group Human Resource Manager for Arnotts, put this succinctly: "the biggest impediment to business is political instability and the uncertain regulatory and taxation environment that comes with it" (Michael, 2005). While other issues certainly make doing business in Papua New Guinea difficult, they can be generally regarded as a tax on the business operation and can be planned and costed into their operations – indeed, several business managers commented to this effect, remarking that expenditure on security and insurance was an essential part of any operation (while noting that these costs were higher in Papua New Guinea than other countries). However, the bureaucratic environment in which businesses operate is unpredictable, and this unpredictability stops long-term investment. This, without a doubt, was the most problematic aspect of operating in Papua New Guinea for the businesses surveyed here.

Despite the dysfunction in the business environment, the outlook of participants remains optimistic. There is a definite feeling that the macroeconomic conditions are improving, and that if reforms can continue there is the potential for a dynamic business sector.

However, this optimism is tempered by caution, and those in the business sector are very aware of the setbacks that can be caused by government interference and poor policy. Part of the optimism in the sector is perhaps based on recent political stability, which has been welcomed by business leaders.

This section seeks to outline some of the major business-focused concerns of participants in the study.

4.1. Politics and Business

The link between business and politics in Papua New Guinea is an “intricate” one and often brings negative outcomes (Kavanamur, 2001:2). This is clearly seen in corruption, which is endemic throughout government and the business environment in Papua New Guinea (May, 2004) and which has had serious negative consequences for development. Unsustainable and exploitative land use, poorly targeted infrastructure development and a culture of are the norm in Papua New Guinea, and politicians are regular recipients of bribes and kickbacks, often also diverting funds from legitimate government activities (Kavanamur, 2002). The legacy of corruption in Papua New Guinea is the focus of many major development activities, and will be left for others to address. However, there is often an assumption made that business begets negative political outcomes which is both incorrect and ultimately detrimental to economic development. Instead, corruption and political interference are significant impediments to business, particularly those in the small to medium enterprise sector. These businesses are not large enough to warrant political attention, and do not have the resources to pay bribes that will facilitate significant advantage. As documented in Manning (1999), corruption is a significant disincentive for new companies and significantly inhibits those already operating.

Interestingly, management from every company interviewed complained about corruption and insisted that they refused to pay bribes. Regardless of the origin of foreign investor, company leaders expressed a distaste for official corruption and a belief that to participate would only serve to exacerbate the problem. There is a belief throughout the business community that to make payments or give favours will simply result in an increase in the number of rent seekers. One Australian company director, with a long history of involvement in Papua New Guinea, told of being asked to pay a bribe to locate imported equipment that had gone “missing” for 12 months somewhere between ports and customs officers. The bribe was paid in the interests of expediency, and the equipment miraculously reappeared. The director swears that this will be the first and last bribe he ever pays, and the incident serves to highlight the fact that even the most committed and ethical of business operators in Papua New Guinea can be worn down by the relentless graft demanded by members of the bureaucracy. Ports and customs officials are particularly able to confound business operations, and chronic inefficiencies give bureaucrats ample scope for rent-seeking behavior.

However, corruption alone cannot explain Papua New Guinea’s poor business performance, nor can the constant law and order problems that plague Lae, Port Moresby and the highlands. Papua New Guinea is ranked #102 on the 2004 Corruption Perception Index along with the Philippines and Vietnam, two economies where business is thriving (Transparency International, 2004). AON Political Risk Services (AON, 2005) ranks Indonesia as a more dangerous business environment than Papua New Guinea, along with much of Eastern Europe and Central America. Most of these economies are far more dynamic than that of Papua New Guinea, and many are growing strongly. While corruption and law and order are certainly negative features of the Papua New Guinea business environment, they are common to many close regional economies, and cannot be the only reasons for the continued lack of business development. Instead, they should be regarded as additional disincentives in a cumulative whole.

Papua New Guinea's bureaucratic infrastructure has become increasingly dysfunctional. Manning (1999) chronicled the increasing distrust of government by business in a survey question aimed to make companies compare the current business environment to that of ten year's prior. While 42% of respondents felt that the Government of Papua New Guinea was hindering business in the late 1980's, this had almost doubled to 78% by the late 1990's. This dramatic increase correlates with a business climate in decline, which was near terminal by the close of the century. Work by Kavanamur (2001) succinctly identified the major political impediments to business as:

- political instability that gives rise to a volatile and unpredictable business environment
- the abuse of political power in frequent hiring and firing of departmental secretaries and state enterprise executives
- decision-making at Cabinet, Parliament and bureaucratic levels lacks rational components because of the dominance of intuition, resulting in frequent policy reversals
- public policy [which] is often based on improvisation and solely geared towards political survival

Kavanamur, 2001:3

Business operators are very concerned about the constant interference of politicians in semi-government industry bodies and state owned enterprises. Kavanamur (2002) has documented the installation of political appointees in these statutory authorities and state enterprises, who often write their own employment contracts and then engineer a way to be terminated. They are then able to (successfully) sue the government for wrongful dismissal. The resulting upheaval and organizational insecurity can effectively negate any positive activities in progress within the organization. This is extremely detrimental to business, and private industry bodies and private business operators generally agree that the statutory authorities would be effective in facilitating business activities if high-quality, appropriately skilled appointees were able to work to appropriate agendas without constant political interference.

The activities of statutory authorities are increasingly viewed with suspicion by members of the industry, and statutory authorities themselves complain of excessive government interference, most notably frequent and inappropriate executive appointments. Business operators point to political appointments made to the National Fisheries Authority (NFA) since 2002 that have seriously impacted on the operation of their businesses. The NFA has had seven different managing directors since the late 1990s, and each of these has created organization-wide upheavals as management priorities have been realigned. The organization, once efficient and functional, is now plagued with bureaucratic failings. One participant spoke of difficulties with license renewals that took place directly after a new political appointment was made to the head of the NFA. Political interest, and interference, in the NFA is a direct function of its profitability and the increasing importance of the fishing industry for export revenues should be resulting in a profitable and efficient organization. Unfortunately, this is far from the case.

The NFA has an industry liaison branch to encourage foreign investment, but it doesn't work well. Investors need certainty, not promotion.

Business Consultant

It is clear that ample opportunities exist for reform and restructuring in those areas of the bureaucracy that oversee industry sectors. Making these areas more accountable and less able to "skim" profits from successful industries and sectors, allowing constituents to elect leaders, not politicians, and eliminating political interference in business matters in general would be of significant and lasting benefit to businesspeople. By restricting political interaction to strategic regulatory reforms and business facilitation initiatives, and removing opportunities for day-to-day interference, avenues for corruption would be minimized. By providing greater stakeholder involvement in the management of regulatory authorities, problems such as inefficient licensing procedures could be mitigated and more timely responses to bureaucratic problems would be anticipated.

4.2. Business Policy and Policy Stability

Emphasis has not necessarily focused on policy stability in the past, it often being overtaken by the more obvious and pressing issue of political stability and electoral reform. While much has been written on political stability in Papua New Guinea (such as Reilly, 2001), less work focuses specifically on the pressing issue of policy volatility and its economic consequences, although there is a recognition that policy stability is hindering the development of domestic business as well as foreign investment (May, 2004). Internationally, there has been a significant relationship documented between economic growth and policy stability, with work by Serven (1999) demonstrating that the link between economic growth and macroeconomic policy stability is particularly cogent for less developed countries. Henisz (2004) observes that "changes in the policy regime that intentionally or unintentionally have the result of altering the value of the revenue stream generated by private sector assets… impact on the decisions of private actors, especially those that include long-lived up-front investments" (Henisz, 2004:2), an observation that neatly summarizes the business environment confronting both foreign and domestic investors in Papua New Guinea. Manning (1999) documents the decline in policy stability that was consistently articulated by members of the business community in this study. While 50% of those surveyed by Manning felt that government actions were predictable in the late 1980s, this had been superceded by the late 1990s, where 85% of respondents felt that government actions were unpredictable.

A high number of firms see predictability as one of the prime things they look at when making a decision to invest… unpredictability… makes it very hard for a firm to commit funds.

Manning 1999:8

In terms of economic policies, Henisz (2004) has shown that, in a survey of up to 172 economies, Papua New Guinea has some of the most volatile policies regarding taxes on capital and profits and goods and services expenditure. Indeed, Papua New Guinea was in the top 25 most volatile countries in 5 of 9 different categories of fiscal policy – and was notably absent in some categories, such as social security taxes, more due to a lack of policy than of policy stabilty.

Policy stability is encouraged by systems whereby the ability of politicians to respond to large numbers of discrete interest groups is minimized. To some degree, recent changes to electoral laws (notably the re-introduction of preferential voting) and other actions promoting political stability are likely to have a positive effect on policy stability by encouraging candidates to respond to a wider range of interest groups, rather than the narrow "wantok" focus encouraged by first-past-the-post systems (Reilly, 2002). There is also broad recognition that political architectures – that is, the constitution and laws that configure leadership and authority within a state – ultimately determine policy outcomes (MacIntyre, 2003). MacIntyre observes that political structures that are based on extremes in the locus of power – either too highly decentralized, or too highly concentrated – result in poor policy management, and this is particularly the case for developing countries. It may be time to reassess the architecture of polity in Papua New Guinea with a view to facilitating policy stability and effective policy outcomes, now that a degree of electoral stability has been realized.

It is often difficult to capture global trends in microeconomic policy activity in a meaningful way, due to the heterogeneity of policy and its sensitivity to the social environment. However, it is possibly in microeconomic policy that a lack of stability most impacts on business. While general fiscal policy regarding taxation and tariffs are of major importance to investors, it is at an industry level that shifting sands can most sabotage and individual business, and by doing so discourage others from establishing their own business.

The most significant and recurrent theme throughout these interviews was the lack of certainty in the business environment. This affects every aspect of business, and was without a doubt the area of most concern to the managers interviewed. Macroeconomic uncertainty is the "big picture" and has set the tone for the operation of the bureaucracy and regulatory bodies that disrupt business activity at a microeconomic level.

4.3. Business Regulation and Uncertainty

Modern development theory and practice readily acknowledges the importance of a thriving business environment to economic growth. One of the greatest obstacles to business development in a developing country is overregulation, which slows the process of commencing a business and significantly increases costs. A common trait of underdeveloped countries is excessively high levels of regulation and compliance for businesses attempting to operate in the formal sector. The World Bank has documented that businesses in poor countries face three times the administrative costs, twice the number of bureaucratic procedures and delays, and have half the protections and property rights of those in developed countries[7]. Additionally, the payoffs of reforms appear to be significant: countries successfully implementing business reforms grew by 1.4 – 2.2% of GDP[8]. Regulatory reform and business regulation streamlining initiatives have proven extremely successful in other developing countries such as Vietnam, where the

[7] World Bank (2005), p. 3
[8] ibid, p. 4

simplification of bureaucratic procedures and licensing has had pronounced stimulatory effects on the business environment (Central Institute for Economic Management, 2004).

One of the constant themes throughout the study of business in Papua New Guinea is the inconsistency of business regulation, and the inefficiency of those regulations in place. Perhaps most worrying aspect is the inconsistency, which not only disadvantages some businesses and industries to the benefit of others, but also creates ample opportunity for corruption and rent-seeking behaviour. The impact is felt particularly keenly by new industries, which are disadvantaged by their lack of existing bureaucratic infrastructure and are stymied by a lack of political networks through which more established industries are able to lobby for favours.

The real issue is uncertainty. If corruption was predictable and consistent, it wouldn't be a problem.

Business consultant

Among the most significant inconsistencies is the application of tariffs on plant and other inputs to the manufacturing process. It appears that some sectors, and some companies, have successfully lobbied for tariff exemption while others have been unable to attain any concessions. Some industries are able to import inputs to the manufacturing process duty-free, while others are not. Bismark Barramundi is currently unable to source appropriate fish food locally, and in a best-case scenario (where local production of some feed was possible) would still need to import around 80% of the food consumed by fish stock. However, a tariff of 64 kina per tonne currently applies, adding significantly to the overheads of the business, despite feed being an essential input with no locally available substitute and despite the official tariff rate for code 2301[9] being zero (Middleton, 2005). While the Investment Promotion Authority website claims that there are "low or zero tariffs on many business inputs"[10], it appears that this is entirely at the discretion of the Internal Revenue Commission. If these laws were streamlined, ad-hoc implementation eliminated, and any industry-specific ambiguities and sector- or company-specific allowances were applied equally to all businesses, it would have an immediate and beneficial impact on small-to-medium enterprises.

As a corollary to the tariff discussion, most businesses in Papua New Guinea are not supportive of moves to lower tariffs. While this is unsurprising in a business community, it appears that those business owners most supportive of tariff maintenance are those benefiting from the inconsistent application of tariffs. Those manufacturers who are receiving tariff-free inputs to manufacturing are unlikely to support the removal of tariffs, as the only tariffs they are affected by are those protecting their business. Conversely, those businesses receiving no tariff exemption are more supportive of general tariff reductions. However, it would be difficult to argue against a consistent application of tariff rules on inputs to manufacturing, where the simplification and clarification of laws would immediately benefit business, reduce the burden on the bureaucracy and eliminate many of the most immediate avenues for corruption. Additionally, competition in areas in which Papua New Guinea should have a strategic advantage, for example, the production of crocodile skins (imports of which will attract a 25% tariff from 2006) seem overly

[9] Tariff line 2301: flours, meals and pellets, of meat or meat offal, of fish or of crustaceans, molluscs or other aquatic invertebrates, unfit for human consumption. It appears that "prohibitions and restrictions" applicable on this line result in the applied rates of duty.
[10] www.ipa.gov.pg, accessed 10 August 2005.

restrictive and only serve to impede competition which could help Papua New Guinea interact more effectively in the global market. It seems unlikely that Papua New Guinea is in danger of being flooded with imported crocodile skins.

Business regulation and licensing is also extremely cumbersome, and license processing is a constant source of problems for private enterprise. Licenses are often not issued until well into the year of applicability. One company possesses a license that took 9 months to be issued – leaving only three months for use before it expired (and which was issued for an employee that had left the company in the interim). At the same time, a crack-down on unlicensed fishing took place with no concessions made for those who had applied to have their licenses renewed but were waiting for them to be issued. Incompatible policies and bureaucratic mismanagement resulted in one fishing fleet forced to wait at shore - this company now has minimal participation in the fishing industry. The poor implementation of licensing is highlighted by the low ranking of Papua New Guinea in the World Bank *Doing Business* surveys (#84,

Table 2).

The elimination of inconsistencies and distortions in the trading environment is one of the most effective and easiest ways to facilitate business activity. It has the added benefit of minimizing opportunities for corruption, and results in far lower overheads for a bureaucracy that already has difficulty providing many essential services. The benefits of streamlining and minimizing business regulation are immediate and will facilitate a more vibrant business environment. It will encourage new businesses to start, and existing businesses to expand. Additionally, there is likely to be a real cost saving to the government as layers of bureaucracy are eliminated. This is an area where simple changes can bring significant and long-lasting benefits to the private and public sector alike.

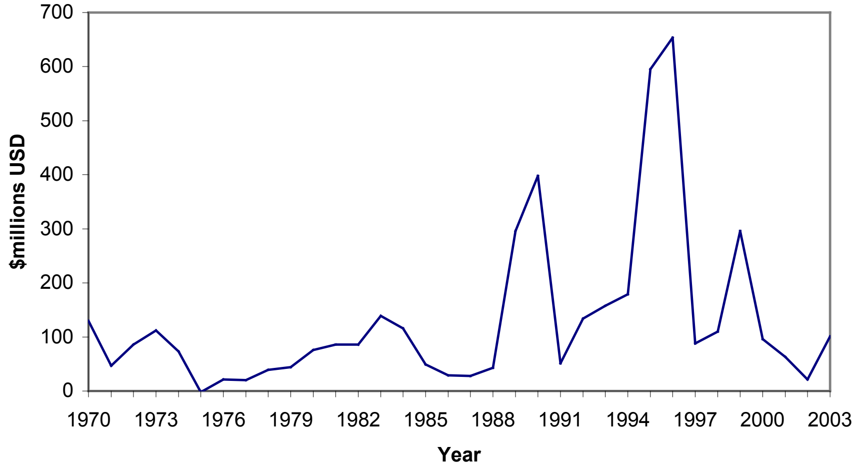
The Foreign Investment Advisory Service (FIAS) has recommended the "guillotine approach" as a method to "clean" unnecessary and unworkable regulations from bureaucratic systems, and has recently launched guillotine initiatives in Kenya and Tajikistan. The guillotine approach requires the administration to publish and justify its regulations within a defined timeframe. Those regulations not published by the date are eliminated, the assumption being that the most important regulations will be published first. Such an initiative could be considered for Papua New Guinea.

4.4. Motivating Foreign Investment

Foreign direct investment can be an important catalyst for economic growth. FDI allows a country to grow at a rate faster than would have been possible with domestic savings alone, as it mobilises capital that was not previously available in the community. Foreign direct investment has been shown to contribute to economic growth in a host country primarily through technology transfer, human capital development and the "demonstration effect" (whereby domestic entrepreneurs model their operations on those of foreign investors, effectively creating a hub of competing industries).

An important attraction of foreign direct investment to governments of developing economies, as opposed to other types of capital inflows, is the stability of foreign capital. The main alternative source of private capital inflow, portfolio investment (investments made in financial products, such as shares, bonds, money market instruments and derivatives), is typically made in smaller quantities, and is quickly and easily withdrawn when economies show signs of weakness. Portfolio investors are looking for returns from financial products like bonds or shares, and are more concerned with short-term profits than long-term operations. As a result, the investor has no incentive to leave money in the host country when economic difficulties strike. Foreign direct investors take a strategic interest in their investments and they often consist of plant and equipment, which is difficult to liquidate at short notice. As longer-term investors, they have goals that make short-term economic instability less important to them. Foreign direct investors are unlikely to withdraw their investment unless things get extremely bad and they decide to leave a market for good.

Figure 2: FDI Inflows to Papua New Guinea, 1970 – 2003

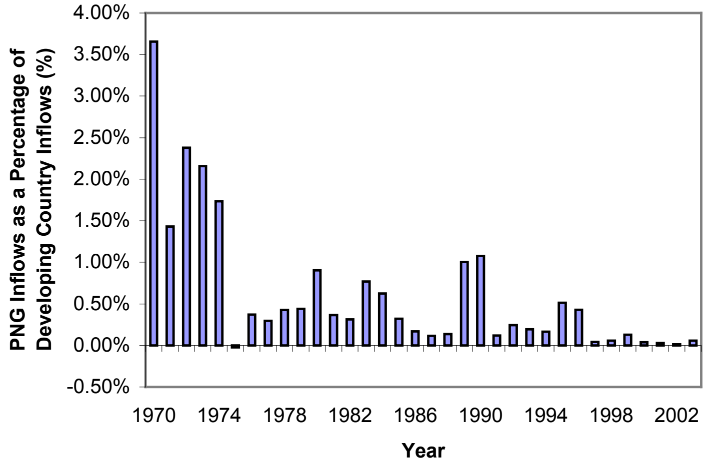


Source: UNCTAD Foreign Direct Investment Database

As a result, foreign direct investment is a much more stable source of capital for developing countries. Albuquerque (2003) states that while long-term financing inflows to East Asia fell by 22% in the wake of the 1997 crisis, FDI inflows fell only 5%. Similar results for Latin America (1980s) and Mexico (1994) indicates that FDI provides far more security for emerging market countries in terms of investment funding. Further, falls in foreign direct investment inflows appear to recover quickly - inflows to Mexico had fully recovered within three years of the 1994 debt crisis. FDI inflows are more stable and less prone to capital flight, and this is particularly so for emerging market economies. As a result, it is important for developing economies to maximize their opportunities to attract FDI and create an environment conducive to investment.

Foreign direct investment in Papua New Guinea has been erratic over the last three decades, with the fairly steady growth observed between 1976 – 1983 replaced by a series of peaks and troughs (Figure 2). Papua New Guinea, with its rich natural resources, is the only Pacific island country to receive significant FDI inflows, and while the amount of capital has increased over the period, it has failed to keep pace with the overall rate of growth in inflows to developing countries. Global foreign investment flows have grown significantly since 1970. Between 1970 and 2003, foreign investment inflows grew around 170%, with the developed world growing around 114%. However, it was the developing world where the most growth took place – a massive 366% increase. In 1970, FDI to Papua New Guinea made up 3.5% of global FDI flows to developing economies – by 2003, this had fallen to less than 0.06% (**Error! Not a valid bookmark self-reference.**). Even near the peak of investment in 1995, FDI to Papua New Guinea made up only 0.51% of global FDI flows. The most significant investments, relative to other developing countries, were made in the four years before independence. Since then, the ratio has dropped significantly and other developing countries, particularly those in Asia, have taken the lion's share of investment.

Figure 3: Ratio of PNG FDI Inflows to Developing Country Inflows, 1970 - 2003



Source: UNCTAD

While Papua New Guinea is still the most significant destination for foreign investment in the Pacific, it ranks 49th of 150 developing countries for total investment inflows between 1990 and 2003 (Table 3). It is also evident that the internal security issues often given as the cause of Papua New Guinea's lack of investment do not tell the full story. Indonesia, Venezuela, Columbia and Nigeria all have at least four times Papua New Guinea's investment inflows: all have more pressing internal stability issues than Papua New Guinea (Aon, 2005). While security is a disincentive to some investors, there is also substantial evidence that investors will invest in a politically and economically unstable country if the rewards are seen to outweigh the risks.

Of the four Dunning (1993) motivations for foreign investment, only two appear truly active in Papua New Guinea: resource-seeking investment, centred around resource-extractive industries; and market-seeking investment, the aim of which is to market products to host country consumers. Of these two, resource-seeking investment overwhelmingly dominates. While Papua New Guinea is far from the least open economy in the World Bank (2005) "Doing Business" survey, the impediments to trade are no doubt exacerbated by high freight costs and poor servicing, corruption within the freight management bureaucracy and overly bureaucratic processes designed to protect domestic industry. It will require significant structural reform for trade logistics to be able to compete with more cost-effective destinations for efficiency-seeking investment.

Of the businesses interviewed, all had their operations underpinned by domestic activity. Only New Britain Palm Oil and RD Cannery primarily service an export market: for the rest, exports were complements to domestic activity, not the purpose of domestic activity.

Table 3: Total FDI Inflows to Developing Countries, 1990 - 2003

Country	Total FDI Inflows 1990 – 2003 (US$ millions)	Percentage of Total Developing Country Inflows	Rank
Developing Countries	**2,019,515**	**100%**	

China	484,270	24.0%	1
Hong Kong (ROC)	199,285	9.9%	2
Brazil	181,187	9.0%	3
Mexico	159,539	7.9%	4
Singapore	133,383	6.6%	5
Venezuela	33,120	1.6%	13
India	28,606	1.4%	14
Colombia	26,867	1.3%	15
Philippines	17,539	0.9%	20
Nigeria	16,283	0.8%	22
Indonesia	13,594	0.7%	23
Papua New Guinea	2,944	0.1%	49
Fiji	533	0.0%	95
Vanuatu	319	0.0%	115
New Caledonia	109	0.0%	127
Solomon Islands	75	0.0%	130
Tonga	26	0.0%	139
Kiribati	7	0.0%	144

Source: UNCTAD

Market-seeking investment is unusual in a small developing economy such as Papua New Guinea: typically, researchers would expect to see market-seeking activity in far larger markets, and this perhaps explains the small scale of operations. The largest market-seeking operation in this study is Arnotts, which employs slightly more than 500 staff and hence qualifies only as a medium-sized business by Australian standards. The limited size of the market makes competitive industry difficult, a fact obvious from the pressure placed on the two corned beef manufacturers, duopoly producers for the last 15 years, by the entry of a competitor in the form of canned fish. In a small, underdeveloped consumer market, there are few opportunities for market-seeking investors.

However, the Medium-Term Development Strategy is focusing on export-led growth. This means that the Government wishes to attract foreign investors who will start value-adding export production facilities, creating jobs and export revenues. Given the reluctance of Australian investors to enter Papua New Guinea and the fact that trade with Asia is becoming increasingly important to the PNG economy (Bowman, 2004), it is fair to say that closer trade and investment ties with Asia should be pursued and encouraged. It is Asia that is providing some of the most dynamic business opportunities both within and outside the resource-extractive industries. Philippine investment underpins RD Cannery and RD Fishing, while Malaysian investment comprises 70% of New Britain Palm Oil. Asian interests are extensive in the fishing area, and Asian expats run many of the smallgoods stores in major townships. It is likely that Asian investors would be the primary source of efficiency-seeking investment, and as the kina has devalued against the Australian dollar, import substitution has taken place with cheap foodstuffs imported from China and ASEAN countries rather than Australia, the traditional source. A “look north” policy, that advocates more closely integrated trade and infrastructure ties, would assist in creating investor interest in value-adding and manufacturing industries.

One of the greatest impediments to trade in Papua New Guinea is the exorbitant cost of logistics. Exporting businesses complain about the high costs of shipping and the irregular schedules. The tuna industry has been devastated by the cost of flying high-quality fresh tuna to its primary market in Japan: quality assurance was impossible, and often chilled tuna was left sitting at the airport in Port Moresby as flights were overloaded or otherwise unable to transport cargo to its destination. Tuna was spoiling because it was being handled so often before reaching its destination – in some cases it was being flown to Australia, trucked to an alternative airport, and then flown to Japan (Chow, 2005). As a result of this and a decline in tuna prices, there are no longer any operations attempting to ship premium chilled tuna from Lae or Kimbe. The high cost of shipping between Lae and Port Moresby is a concern for all businesses involved in shipping product, and the frustration of costs being on a par with shipping from Singapore to Brisbane are keenly felt. Domestic port costs are "awful" (Kingston, 2005), and the Swires monopoly on Pacific costal shipping means that there is no competition on major routes. Getting goods to Fiji can require a transit through Brisbane. In general, the state of transport logistic is poor and ways need to be found to make major trading centres such as Lae and Madang cost-effective and competitive with similar centres in neighbouring Asian countries. Papua New Guinea has the advantage of being extremely close to Asia, and should be able to ship cost-competitively to Singapore and other major Asian ports. Improvements in logistics infrastructure, particularly the removal of many monopolies on major routes, would enable Papua New Guinea manufacturing and value-adding industries to be more globally competitive.

As well as locational advantages, there are cultural synergies between Asia and Papua New Guinea. Lucas Michael, Group Human Resource Manager and change management consultant for Arnotts' Asian business operations, commented that "there are many similarities between the Asian way of looking at things and the PNG culture" (Michael, 2005). With these cultural intersections, Asian trade and investment may be particularly desirable for Papua New Guinea. Concerns by some Australians within the bureaucracy that Asian investors were more likely to engage in corruption seem unfounded. Asian investors certainly articulated a negative attitude to corruption in these interviews, and expressed the same views as Australian managers that to give in to corruption would be to invite a lifetime of rent-seeking behaviour. One (expat Australian) manager commented that "Asian business won't talk about it, but they must have a similar attitude to us [about paying bribes] or they wouldn't be encountering all the same problems that we do". While no doubt experienced with corrupt bureaucratic environments in their home countries, Asian investors are not keen to encourage this behaviour and negative attitudes toward small- and medium-sized businesspeople working within the formal economy are inappropriate.

4.5. Developing the Skills Base

Efficiency-seeking investment underpins an export-led growth strategy. While the Government of Papua New Guinea is attempting to encourage domestic processing operations, it seems unlikely that these will eventuate without the presence of significant efficiencies in the Papua New Guinea economy. The greatest obstacles to efficiency-seeking investment are generally regarded as skilled and semi-skilled labour supply and costs and transportation costs. While the Government of Papua New Guinea is encouraging value-adding operations, in some cases the operations may have limited purpose. A relatively new development, the Ramu Nickel/Cobalt project in Madang, has a low-grade processing operation and there is some skepticism as to how economic this activity will be and how much is driven by political considerations. There is a general belief that ultimately processing will be performed offshore, with China importing ores and refining them domestically to capitalize on its own labour and technology efficiencies. This is regarded as a likely outcome for those interviewed in this study, and similar comments have been made with regard to the tuna canning industry. While the tuna canning industry is currently seen as successful, it is also highly sensitive to the prevailing trade environment[11].

The Government of Papua New Guinea's export-led growth strategy is an optimistic attempt to stimulate economic development, but considering the current profile of foreign investment in the country, it is possibly overly optimistic to envisage an expansion of the export base without a significant structural shift in the business environment. Export development must be based upon a country's comparative advantages, and successful export-led growth strategies have taken place in countries with significant economies of scale that foreign investors are able to exploit. Export-led growth in East Asian countries, where it has been most effective, has typically begun in low-cost manufacturing and increased to high-technology production as the skill and technology base of the country increased. Japan, Korea, Taiwan and more recently China and Vietnam have followed this pattern, with manufacturing moving to more cost-effective locations as the skill and income base of the population rises.

The skill base of Papua New Guinea has some structural problems that impede business activities. Numerous managers highlighted the problems caused by the cycles of the mining industry - in the words of Robert De Brouwere, of James Barnes PNG Ltd, "mines blow everyone out of the water" (De Browere, 2005). Skilled tradespeople are in high demand on mining operations: as a result, when the mining industry is experiencing a boom, manufacturing operations are unable to compete with the salaries offered and frequently lose key staff. When staff return from working at the mines, they anticipate similar wages to those they were being paid by the mining companies. The inability, and/or unwillingness, of manufacturers to pay these rates creates frictions as the workers re-assimilate in the urban manufacturing environment. The pool of highly-skilled tradespeople is small: many were trained by the Bougainville mining operation that has since closed, and government training facilities are unable to provide graduates of the quality or quantity required at peak mining periods. Several managers commented on the poor quality of training being provided by the technical colleges in Papua New Guinea. Additionally, a small manufacturing base means that there are few tradespeople with specialized skills in new technologies, requiring manufacturers to import staff, typically from Australia, at great expense. The lack of a self-sustaining manufacturing base means that efficiency-seeking investors are unlikely to locate to Papua New Guinea when it is far easier to find such staff in alternative Asian destinations. This merely exacerbates the skilled staffing problems for existing manufacturing businesses in Papua New Guinea.

One positive note: a number of business people employing large numbers of unskilled workers believe that their staff are as productive and cost-effective as any found in Asian countries. The widely-held Australian belief that Papua New Guinea workers are unwilling or unable to compete with Asian workers, both in terms of productivity and work practices, is simply incorrect. The decline in the value of the kina against Asian currencies has done much to improve this situation, and further devaluations of the kina should be regarded as beneficial to the business environment, particularly in terms of making wages more regionally cost-competitive.

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[11] See section 4.7 for a discussion of the impacts of trade preference elimination on the tuna processing industry.

The concept of investment hubs has been used to good effect by a number of countries, most recently China, which created a number of "export processing zones" which have since become the centre of Chinese trade on the east coast. Investment hubs, or clusters, are specialized concentrations of firms with operational synergies, which are able to take advantage of a pool of infrastructure and resources (both human and otherwise) that grows and strengthens as more companies join the hub. Spillover effects mean that there is significant long-term advantage to be gained by joining a cluster, and that accelerated growth is possible. Business studies have long recognized clusters as drivers of innovation, facilitating business development by increasing the productivity of the companies in the cluster, and by stimulating new businesses (Porter, 1998). Yehoue (2005) creates a model that suggests that the accelerated economic growth of some developing countries may be explained by clusters that have established organically, and proposes that policies directed toward the establishment of clusters could generate significant economic gains by host countries, both by attracting foreign investment and stimulating domestic enterprise.

However, a by-product of government incentives for industry development in Papua New Guinea seems to be a desire to replicate business successes as widely as possible – several interviewees repeated stories of bureaucratic visions of "a tuna factory in every port"[12], mimicking the "meat cannery in every town" scenario of the late 1980s that saw the establishment, and subsequent departure, of competitors to the previously monopoly-assured James Barnes PNG Ltd[13]. If an export-led growth strategy is to be pursued, a it is likely that development hubs will be required if manufacturing business is to grow, diversify and remain viable. A manufacturing hub, most likely in Lae, with appropriate technical training support would be an obvious choice, and a canning hub is already evident in Madang. A more focused approach to the development of hubs with core competencies and supporting infrastructure may assist in promulgating an export-led growth scenario. Certainly this would be preferable to an ad-hoc development strategy seemingly designed for political purposes. Articulating a cohesive industry development strategy would be an effective first step by the bureaucracy.

4.6. Business and Capital

None of the companies interviewed for this report were wholly Papua New Guinea owned. Instead, all had relied on foreign capital to finance the majority of their startup costs. All of the companies remain to some extent foreign-owned operations, from a minimum of 49% to upwards of 80%. Several business owners commented that it was nearly impossible to get private financing for PNG-based businesses: Australian investors were wary of operations in Papua New Guinea, and local funding simply wasn't available to many in the private sector. One business commented that bank financing was readily available when an appropriate relationship existed between the borrower and the lender, but there are few opportunities for those starting greenfields ventures. None had sought a listing on the Port Moresby Stock Exchange although some had domestic funds, such as the Public Officers Super Fund, as significant shareholders.

[12] There is indeed fish processing in every port: South Seas Tuna in Wewak, RD Cannery in Madang and Frabelle in Lae.

[13] Having been awarded a 10-year monopoly, James Barnes PNG Ltd was surprised to discover that Huttons, based in Lae, and Ox and Palm, based in Port Moresby, were setting up operations before the first can had been produced by the Madang Globe factory (De Brouwere, 2005). Huttons subsequently ceased operations.

The issue of capital financing for business activity is of primary interest to indigenous business in Papua New Guinea. Taxi drivers regularly discussed the difficulties of obtaining money to fund business ventures, and it seems to be common wisdom that funding business is an almost insurmountable hurdle. Some Australian academics have expressed a belief that secure land title would free up capital, and indeed this is a central argument of popular work by De Soto (2000). The need for entrepreneurs and business owners to have access capital is widely acknowledged, and the opportunities for bank lending are few. Unsurprisingly, Papua New Guinea ranks extremely poorly regarding access to credit in the World Bank's Doing Business survey (#98,

Table 2).

Remedies such as the use of land titles to give access to capital are regularly promoted, and the issue of secure land title in Papua New Guinea is a central theme in both academia and with Australian policy makers. However, it is uncertain whether the application of secure land title would be enough to encourage bank lending. A prevailing culture of appropriation, where even alienated land is contested when entrepreneurs appear to be profiting from its use, means that banks appear to be unwilling to lend against anything other than urban land in the major capitals of Lae and Port Moresby, no matter how secure the title may be. Kiap Komun (2005) expressed a belief that rural land titling was futile, as no resale market existed for the land and banks presently will not lend against titled rural land. Entrenched cultural attitudes toward land sharing and family communities meant that it was unlikely that there would ever be a market for rural land holdings. As a result, any attempt to raise money from rural land title was unlikely to succeed, and alternative methods of enterprise financing should instead be pursued.

The experience of Aboriginal Australia echoes these finding. A recent report commissioned by Oxfam (Altman, Linkhorn and Clarke, 2005) investigating the viability of increasing land ownership among remote Aboriginal communities to stimulate development is correspondingly negative. The report concludes that the resale opportunities for land in these areas were limited or non-existent, and that banks and other financial institutions were unlikely to lend money to individuals or families in these areas. The report concludes that there is "no evidence to suggest that individual land ownership is either necessary or sufficient to increase economic development"[14].

It is likely that the case for credit has become bogged down in discussions about the merits and feasibility of land title, to the detriment of the central point of the discussion: the facilitation of business activity. In North America, where there is a long history of secure land title, the most common source of micro-business finance is from family, friends and credit card borrowing. A study of microentrepreneurs (those running businesses with fewer than five employees) commissioned by Accion USA, found that of an estimated 13.1 million microentrepreneurs in the US, 82 percent had never accessed formal bank business credit[15]. Similarly, in a survey of Canadian businesswomen it was found that 40 percent of women used their personal savings to start businesses, and 35 percent of women used personal credit cards[16]. Even in developed countries, women are particularly risk-averse and are less likely to finance a business using an asset that is regarded as essential for personal stability, such as the family home. It is likely that the importance of land as security when starting a small business has been overstated, and it is clear that entrepreneurs in the developed world regularly find forms of finance other than bank lending against property when starting new enterprises.

A similar story is evident in the emerging economies of East Asia. Family savings are the primary form of start-up capital used to establish private enterprises (Pistrui, Huang, Oskoy, Jing and Welsch, 2001), and in the past little use has been made of banks and government assistance. A study of indigenous Australian entrepreneurs by Foley (2000) found that the majority of Aboriginal entrepreneurs were funded by family members and friends, or through borrowing on credit cards. Nationally administered schemes such as

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[14] Altman, Linkhorn and Clarke (2005), p. 5

[15] Accion USA, http://www.accionusa.org/mediakit.asp, accessed 21 July 2005.

[16] *Survey on Financing of Small and Medium-sized Enterprises 2000*, Statistics Canada, 2000

those provided by ATSIC were found to be difficult to access and unhelpful, and traditional lenders were not forthcoming with assistance. Foley identified microfinance as a possible avenue for venture financing among Aboriginal Australians, and moves are now underway to provide access to microfinance in regional Australia[17]. This is being provided primarily by major banking institutions, including the National Australia Bank and ANZ. It is likely that similar moves by the ANZ in Papua New Guinea may do more to encourage business activity than politically difficult attempts to title rural land, and an argument that directly ties a lack of business innovation with a lack of secure rural land title for borrowing is likely to be seriously flawed. While myriad arguments exist for the implementation of secure land titles, arguments should not be made based upon the principle that land title would improve access to capital for indigenous entrepreneurs.

Certainly improving access to capital in Papua New Guinea is essential. Indeed, there is some evidence that access to credit can help to overcome some of the disincentives to business activity created by policy instability on business (Lensink, 2000). However, it does appear that established businesses, and non-indigenous business, have somewhat less difficulty raising finance than newer businesses. Several business owners indicated that they had no problem raising capital, that with an established link to the community and with a history of business activity, there were many opportunities to borrow from banks. Other, less established business owners, seeking capital for new initiatives, expressed frustration with attempts to interest Australian investors in Papua New Guinea. The opinion was expressed that raising significant levels of investment funds from private investors domestically was next to impossible. Further discussions with economists suggested that lending practices by banks operating in Papua New Guinea are overly conservative, and that there are significant differences in lending practices between the banks in Australia and their branches in the Pacific. There remains a real question as to why access to credit for indigenous and new business is so tight in Papua New Guinea, and there is a need to clearly establish the underlying problem before attempting remedies.

Considering that there are a comparatively large number of banks operating in PNG, and that there is obviously a market for credit that is being successfully serviced by payday lenders and "loan sharks" at exorbitant rates, it is interesting that offerings of credit, even at comparatively high rates that provide adequate compensation for the level of risk, are not being made available by banks. Why no reputable organisation has moved into this area to fill the gap is an obvious market failure that requires careful study. As an otherwise functioning commercial environment, any intervention in the market must be made with extreme caution and with an awareness that financial institutions will attempt to maximise their operational benefits from any intervention activity, and will indeed structure their business in such a way that they may become "dependent" on assistance to continue.

4.7. Trade Preferences

One of the recent success stories in Papua New Guinea is the development of a tuna canning industry, spearheaded by the Philippine investment in RD Cannery and RD Fishing. This cannery is the major business success in what has otherwise been a lacklustre commercial environment over the last 5 years, and while it has been plagued

[17] *Micro steps on the path to indigenous wealth*, Fiona Carruthers, Australian Financial Review, 8 July 2005

with various bureaucratic, regulatory and social problems, the cannery continues to grow and operate profitably. The entire RD Cannery export supply of canned tuna (70% of production) is sent to Europe under the existing Cotonou preference arrangement.

The Cotonou Agreement, signed in June 2000, was an initiative of the European Union aimed to give a group of African, Caribbean and Pacific (ACP) countries preferential access to EU markets and marked the final phase of a series of agreements that started in the early 1960s. Their aim was to deepen trade with 40 Least Developed Countries (LDCs) by providing duty-free access to markets for most industrial products and reduced tariff access for agricultural products. The aim of these agreements was articulated in Cotonou as "fostering the smooth and gradual integration of the ACP States into the world economy, with due regard for their political choices and development priorities, thereby promoting their sustainable development and contributing to poverty eradication in the ACP countries". This plan was not only altruistic – most members of the ACP have been colonies of European countries at some stage, and there was a strong motivation to assist those countries whose colonial pasts may have been less than idyllic. There was a historical basis to the agreement – there had been trading arrangements with many of these countries dating back to the communist days, when European politicians were concerned about maintaining influence in the former colonies. Trade preferences were regarded as an important way to assist developing countries to establish themselves in the global marketplace. While they seemed to work well with some countries, notably those from Asia, the LDCs have been left behind. The first signals of the ultimate demise of the Cotonou arrangment began in 1999 when the EU was taken to the WTO over banana quotas. In response to this and other issues, Cotonou was written with the expectation that preferential agreements would be phased out so that all participating countries complied with WTO legislations.

Cotonou will now conclude in 2008. As a result, the EU will gradually phase out preferential arrangements in the forms of tariffs and quotas and instead grant ACP countries compensation to assist with structural reform for affected sectors. This is small comfort for RD Cannery in Madang. When these trade preferences are removed, as they are likely to be at the conclusion of the Doha round, Mr Pete Celso, managing director of RD Cannery in Madang, intimated that the operation would be uneconomic. RD Cannery is certainly lobbying hard for preferences to be retained (and for European quotas to be increased), and it is likely that this position will have considerable sympathy within the Papua New Guinean government given that RD Cannery actively courts a high profile and political recognition. While this is almost compulsory for a business this size in Papua New Guinea if it is to function successfully, RD has been very effective in self-promotion and stages numerous functions hosted by various members of parliament. It's effectiveness is evident from the fact that it now dominates the domestic canned fish market, which has grown in size significantly since it entered.

The erosion of trade preferences and tariff reform pose a serious threat to Papua New Guinea business. While no economist would argue for the retention of either of these, as they are trade distorting and of no long-term economic benefit, there is no doubt that a number of existing businesses are likely to be severely financially impacted by their removal. Given the small size of the Papua New Guinea business community, this is a real threat to its long-term viability and it may take years to recover from a serious blow to the sector. It is therefore of vital importance that suitable support for restructuring and industrial reform be in place so that these businesses can be assisted to adjust, rather than simply fold. Likewise, reform of the business environment, particularly the regulatory environment, may go a long way to mitigating the ill effects of trade reform. However, if no reforms take place in this area and the status quo is maintained, it is likely that there will be severe repercussions from the outcomes of the Doha round.

5. Suggestions for Future Research

While compiling this report, it became apparent that the business environment in Papua New Guinea ceased to be a focus of research in the early 1990s. Despite the significant changes in the economic environment since then, and international recognition of the need to create and facilitate trade (and hence business) to generate economic growth, research on business activity in Papua New Guinea has been almost nonexistent. A literature search for Laos[18] results in many articles, most written recently, directly relating to business, foreign investment and business facilitation activities (such as microfinance). The same search performed for Papua New Guinea finds typically older anthropological articles, discussions of investment in education and the inevitable land reform discussions. There are many areas relating to business – entrepreneurial activity, international trade and investment, - that would benefit from high-quality research and which would provide guidance for policy makers. There is an obvious lack of interest, or lack of encouragement for those with interests, in academic business research, and it is clear that it is precisely this area that requires greater understanding by academics and policy practitioners alike, and which can lead to innovative policy direction and reform. The following are suggestions for areas which would benefit from targeted research.

5.1. Business Policy

Policy stability was a recurring theme among the businesses interviewed, and is perhaps currently the least understood aspect of institutional development. The academic literature of policy stability is young, and is only beginning to be defined. While it is widely acknowledged now that fiscal policy stability is essential for economic growth, there has been little research undertaken to identify the relationship between different institutional structures and arrangements and the facilitation of growth. Little work has been done in this: with an emphasis to date on the electoral structures of government, it is perhaps timely that work begin on the mechanisms of government and way in which policy stability might be encouraged.

An important aspect of this is to look outside Australia and Papua New Guinea's inherited systems for best practice. While MacIntyre (2003) does not explicitly research Papua New Guinea, he observes that developing countries with democratic governments typically have "party systems are likely to be fluid and fragmented, thereby increasing wide dispersal of decision-making power across fractionated legislative coalitions". This problem, then, is not unique to Papua New Guinea, and there are likely to be many lessons that can be learned from the global experience with democracy and development that could be applied to successfully develop political systems in Papua New Guinea. Institutional design is as important for governance as the effective operation of the institutions themselves. A detailed exploration of the relationship between political structures and policy stability in Papua New Guinea may both advance academic research and give practical guidance that could benefit governance initiatives. Additionally, may provide an opportunity to explore innovative solutions directly tailored to existing institutions and cultural norms.

Many developing countries have likewise struggled to find innovative policy methods to facilitate business development and a vibrant business environment. Research that

[18] The population of Laos is only 12% greater than Papua New Guinea's but has a similar poverty profile and is therefore relatively comparable for these purposes.

investigates the catalysts of business in developing economies, focusing on policy and public structures, could feed into the Medium-term Development Strategy and its successors. It is clear that there is currently little effective planning for business development : research and recommendations can complement and assist Agency work in capacity building and the development of longer-term strategies for the business sector.

5.2. Entrepreneurship and Indigenous Business

One of the great “missing links” in Pacific business is the entrepreneur. While historical studies indicate a lively business environment in pre-colonial times (cite here), more recently entrepreneurship has been suppressed by the choice of politics as the most appropriate activity for the “best and brightest” (Michael, 2005). Entrepreneurship creates businesses, facilitates human capital development and introduces new products or services and new methods of product or service delivery to a country. Schumpeter (1949) defined the growth-creating activities of entrepreneurs as *combinations*, specifically: the introduction of a new good or new quality of good; the introduction of a new method of production; the opening of a new market; the conquest of a new source of supply; the creation of new organisational systems within an industry through structural adjustments. Schumpeter was a proponent of creative destruction, a phrase he used to describe the process of new innovation replacing accepted practice, and emphasised its role in generating growth.

It could be added that *disruptive innovation*, a term coined more recently to describe particularly technological changes that have profound impact on business systems, is an extension of this phenomenon, and has become a primary method of recent economic growth, particularly in developed economies. It is entrepreneurial activity that takes advantage of disruptive innovations and applies these innovations throughout the world to generate economic growth. Indeed, the vision of the entrepreneur as the leading force in economic growth has been recognised in the development of the Lisbon Strategy, the development plan adopted by the European Union in 2000 which attempts to stimulate growth in the currently stagnant economies of western Europe.

Creating a climate that facilitates entrepreneurial activity is a primary focus of the Medium-Term Development Strategy, which states that number one of ten guiding principles is “Private Sector-led Economic Growth: To trigger the private sector, including ordinary Papua New Guineans in rural communities, to become productively engaged in growing the economy, by harnessing the entrepreneurial spirit.”

The entrepreneur in the Pacific is of interest particularly in its ability to question the understood paradigm of an entrepreneur. Fairbairn (1988) posits that Pacific kinship structures and the prevalence of family-based activity require the traditional Western notion of an entrepreneur as a lone innovator to be reassessed. It may not be appropriate to expect Western-style innovation to take place in countries with significantly different social structures. Instead, it may perhaps be more relevant to look to similarly socialised societies for models to encourage entrepreneurial development - many Asian countries emphasise family business, and family businesses have been particularly integral in the development of their economies. 60% of all SME’s in China employ at least one family member full-time within the enterprise (Pistrui, Huang, Oskoy, Jing and Welsch, 2001), and 28.6% of these had more than one family member working full-time.

But while a substantial amount of research has been done in recent years on entrepreneurship in some of the world's poorest countries, as well as those where relatively rapid development has occurred, none has focused explicitly on Papua New Guinea. Indeed, little has been done on Papua New Guinea specifically since the publication of Finney's "Big Men and Business" in 1973. Research in other countries has included studies on the activities of companies formed and operated by local entrepreneurs, and has emphasized the importance of understanding the historical trajectory by which local firms have developed. From this, lessons can be learned and policy recommendations can be made that are tailored to the cultural and regulatory environment of the specific country, resulting in an improved climate for entrepreneurial activity.

There is no history of business activity for Papua New Guinea. There are few detailed studies of either the investment climate, or of the activities of firms, their owners and their managers. There are a few dated accounts of some of the earlier, late colonial local companies, but no comprehensive study exists of either that period or the post-Independence period. The first ten years after Independence saw local business people take over many of the areas previously occupied by expatriate owned and operated plantation and trading companies, and many became substantial urban real estate owners. But there is no detailed study of local companies or entrepreneurs over the last twenty years.

To what extent local business people were involved in mining and logging, and the activities surrounding these operations, is so far largely unexamined. While it is known, for example, that in the 1970s and 1980s Bougainville Development Corporation were becoming all-important in mining, plantation agriculture and moving into manufacturing, what has occurred in other provinces where there have been mines and logging operations is less well understood. Additionally, a major subject which needs investigation is to what extent earlier profitable activities, in agriculture as well as other areas, have provided a platform for a next phase of commercial expansion, especially but not solely by local business people. Did successful retail activities, especially during periods of commodity booms, form the basis for moves into areas of manufacturing and services within the country? And to what extent have profits accrued by local business people been held in relatively liquid forms, or invested overseas, perhaps because of expectations that these forms of investment are superior to investment in production or trade within Papua New Guinea? That is, would an improved investment climate encourage local business people to invest within PNG, or are the most likely beneficiaries of any improvement likely to be international investors, which in turn could fuel greater popular opposition to foreign dominance?

It is frequently asserted that corruption is a major problem limiting development in PNG, but there has been no detailed investigation of the connection between forms of corruption and success or failure in business. It is well known that corruption has been an integral feature of the early as well as recent development of businesses in many countries, including Australia and the USA. However to what extent corruption is functional or dysfunctional for corporate expansion and particular entrepreneurs is unknown for PNG.

Greater attention needs to be paid to the needs of indigenous businesspeople, and programs need to be put in place to encourage entrepreneurial behaviour. The absence of this is starkly illustrated by anecdotal reports of business-qualified university graduates working as bank tellers and flight assistants as there are simply no appropriate business analyst positions available within the Papua New Guinea economy. Encouraging an entrepreneurial environment is not costly: simply remedying many of the disincentives to enter business will encourage greater entrepreneurial activity, and a greater focus on entreprenurship in existing business courses may complement this. Ultimately, defining a model of indigenous entrepreneurs may assist in creating interventions that are better targeted to stimulating entrepreneurial activity, and this may be a rewarding avenue for focused research.

5.3. Foreign Direct Investment, Corruption and Other Influences

As noted in Section 4.4, foreign investment inflows are an important source of revenues for emerging market countries. However, in the context of developing economies, their determinants are poorly understood. Of the important disincentives for FDI, governance has attracted much interest, and this is particularly relevant to emerging markets and Papua New Guinea. Of the many facets of governance that can influence investment, corruption is one of the most readily acknowledged. There is a general assumption throughout governance initiatives that the removal of corruption will lead to an improved investment climate, one where foreign investment will stimulate the economy and produce positive outcomes as a result. Some evidence lends weight to this hypothesis (Wei and Wu 2001; Wei, 1999), but it is based primarily on studies of non-Asian OECD investment, particularly that originating in the USA.

Corruption is an ever-present problem in the Asian region, in both bureaucratic and corporate environments. Some studies of developed economy FDI flows find evidence to indicate that developed economies are unwilling to invest in countries perceived as corrupt, particularly if the developed economy has regulations governing the behaviour of companies when operating in foreign countries (Wei, 2000). Vinod (2003) found that corruption in small open economies, such as those in Asia and much of the Pacific, contributes to market failure that in turn acts as a deterrent for foreign direct investment. However, there is an implicit assumption in these studies that FDI originates in developed western economies (particularly the US), and they rely heavily on OECD data. But East Asia is becoming an increasingly important trading partner for Papua New Guinea, and is a significant foreign investor. As Asian economies grow and becomes more affluent, wage-based advantages will be lost and new, stable and efficient sources of low-wage labour will be sought. Ng and Yeats (1999) note that “assembly operations, which are labour intensive, tend to migrate to low-wage East Asian countries”. There is no reason that Papua New Guinea should not be a beneficiary of the search for low-wage manufacturing environments. Certainly those operations currently operating in both Papua New Guinea and Asia (these being New Britain Palm Oil and RD Cannery) believe that wages for very low-skilled workers are relatively competitive with Asia, and productivity in some areas is in excess of that observed in Asia (Dann, 2005).

So is corruption in Papua New Guinea a significant deterrent to Asian investors? Wei (2000) notes that Japan seems to be less affected by the presence of corruption than other investors, given its substantial investment in China. Wei (1995) observes that US and other “western” investors under-invest in China while Japanese investors seem to invest appropriately given the size of China, its workforce, and other economic characteristics. Until now, the motivations behind Asian FDI been assumed to be similar to those of established economic powers in Europe and America. However, it is questionable whether corruption acts as a disincentive to intra-Asian FDI and research that clarifies this issue would be relevant and timely.

Additionally, qualitative research that attempts to determine what does attract investment in Papua New Guinea, and what is openly creating disincentives, would assist in the formulation of policies and initiatives aimed at promoting foreign investment. Existing investors have cited business uncertainty as an underlying problem. Ex-post discussions with investors who strongly considered investing in Papua New Guinea, but who were discouraged and ultimately failed to invest, would lend weight to some of the findings of this report and perhaps further illuminate the motivations of investors in Papua New Guinea. A study conducted in partnership with a statutory authority such as the Investment Promotion Authority could be an effective way to conduct this research.

6. Conclusion

Papua New Guinea is a country rich in resources and poor in human development. The business environment has been stagnant for several decades, and there are few enterprises outside the resource-extractive industries. Small-to-medium enterprise in Papua New Guinea is particularly constrained through a combination of business environment instability, overt political interference in industry regulation and management and a restricted labour, infrastructure and technology base. The nation-wide problems with law and order and corruption are simply icing on the cake after these issues are considered. As a result, few of the businesses interviewed are thinking of expanding – indeed, several have recently engaged on restructuring and have reduced rather than increased the number of staff employed. Without significant reform, it is unlikely that the ambitious targets of export-led growth outlined in the Medium-Term Development Strategy will eventuate. Growth outside the mining and forestry industry is fragile, and a lack of security over land tenure and usage has made planning difficult for those considering expansion.

However, the outlook is not bleak. There are many opportunities for simple reforms that could dramatically alter the business environment for the better, if political and bureaucratic will exists to make these reforms and stick with them. Many of these initiatives could be implemented with few costs – indeed, there are likely to be savings to both business and the bureaucracy if effective streamlining were to take place, and many opportunities for corruption could be eliminated.

With a renewed focus on the business environment in Papua New Guinea, it may be possible to work with the existing business community and new entrepreneurs to create a vibrant and successful core cities with prospering workforces. But without the will to reform, Papua New Guinea is likely to progress no further than it has in the last few decades. Ultimately it is up to the Government of Papua New Guinea to implement changes that will lead to prosperity and security for its people.

Appendix A: Acronyms and Abbreviations

ADB	Asian Development Bank
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
AusAID	Australian Agency for International Development
BPNG	Bank of Papua New Guinea
DFAT	Department of Foreign Affairs and Trade (Australia)
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service (World Bank Group)
GDP	Gross Domestic Product
GNP	Gross National Product
GRDP	Gross Regional Domestic Product
HDI	Human Development Index
IFC	International Finance Corporation (World Bank Group)
IMF	International Monetary Fund
IPA	Investment Promotion Authority (Papua New Guinea)
NFA	National Fisheries Authority (Papua New Guinea)
PNG	Papua New Guinea
SME	Small to Medium Enterprise
UNDP	United Nations Development Program
USA	United States of America
US	United States (of America)
WTO	World Trade Organization
WB	World Bank

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