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Papua New Guinea: Trade Policy and Trade Agreements

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Introduction

Despite two major mineral commodity booms over the past two decades, Papua New Guinea's average per capita Gross Domestic Product (GDP) has been on a declining trend since independence. GDP growth has been unable to keep up with population growth. Undoubtedly, the elite in Papua New Guinea (PNG) have done well during this time, which means that people at the lower end of the income scale have done even worse than that implied by the downward trend in the average per capita GDP.

Several questions arise from this observation:

- Although a great deal of the revenue from the exploitation of the mineral and forestry resources has flowed through to communities, why has this revenue not been used to better effect in funding investment, job creation, and ultimately economic growth? Getting an answer to this question is important, if PNG is to see a better outcome from the implementation of the impending LNG project.
- Would different trade policies have led to a

different result? The outcome could hardly have been worse!

- How can trade policy lead to a better outcome in the future?

Is it market access or market entry?

An open trading system, resulting in good growth in exports and imports, is acknowledged as a key driver of economic growth and incomes. However, exports do not appear to have 'driven' the PNG economy, as they have with the fast-growing Asian economies.

Many students of economics have made the observation that there is not convincing evidence of a positive relationship between trade openness and increased growth and that other factors, particularly so-called 'institutional' factors, are important in determining whether the removal of restrictions on trade and opening the economy to competition will lead to faster growth. The 'institutional' factors that are seen as being particularly important are secure property rights, the impartial enforcement of contracts—or more generally, good law and order—and the enforcement of regulations to ensure that there is effective competition.

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Impact of internal binding constraints

We have seen the impact of internal 'binding constraints' over the years. The floating of the kina in 1994, and in effect, the removal of the 'Hard Kina' policy, with its inbuilt bias against exports, should have resulted in an expansion of PNG's exports as they became much cheaper to the rest of the world. However, there was no explosion of exports as a result.

The extensive tariff reform that was undertaken in the 1990s also should have led to increased domestic import-substituting production and exports, if there were no other constraints. However, again, there was no response.

The lack of response cannot be blamed on 'market access' because through the Australia-PNG Trade Agreement and SPARTECA, Papua New Guinea has free access for exports to its large, rich neighbour. Through its membership of the World Trade Organisation, PNG has virtually free access to the other major developed country markets. It appears that PNG has a 'market entry' problem rather than a 'market access' problem. However, quarantine barriers do present obstacles to the exporting of fresh agricultural products.

Anyone who is familiar with PNG, will know that 'entrepreneurship' is not a constraint. The response to the high world prices for vanilla demonstrates that Papua New Guineans respond to higher prices and market opportunities. The willingness to invest, if the opportunities are available, is also not a constraint, as witnessed by the investment of recent years in high-priced urban real estate. This market, which is based on freehold land—and real estate markets in Cairns and the Gold Coast—has probably been the recipient of much of the resource revenue that has been invested. However, this has done little for sustained economic growth for Papua New Guinea.

Secure access to land, the high cost and unreliability of utilities such as power and water, and law and order problems facing personal and physical security have been other possible constraints highlighted in business surveys which have been conducted over the years. The concept of industrial parks was intended to mitigate, if not overcome, these problems by providing secure access to land, reduced costs of utilities, and personal and physical security.

However, judging by the lack of success of the

industrial park in Lae, this has not been the solution for small business.

As demonstrated in the survey of the Papua New Guinean economy for 2009, the regulations facing business can be improved. The Government's objective should be to focus on those regulations that will lead to improved competition, rather than regulations that just inhibit business.

The widespread lack of access to finance because of the absence of a mechanism for making customary land a securitisable asset, which is accepted by commercial banks as collateral, has been a major 'binding constraint'. Hopefully, that problem will be overcome with the implementation of the recently passed land legislation. We wait with keen anticipation to see whether the commercial banks will accept long-term leases of customary land as collateral.

High internal cost of transport by air, road, and sea is another inhibiting factor. This problem is manifested most starkly in the difficulty that the Highlands provinces have in servicing the hotel market with fresh fruit and vegetables. Hopefully, the resort hotel market will expand as the result of recent improvements in competition. However, will we see the same lack of response by the farming community to the growth of this market, as occurs in Fiji, where they import most of the food supplied to the 650 000 or so tourists each year? There, the problems appear to be lack of continuity of supply and inadequate quality. Although both problems appear amenable to improvements in farming systems and product quality from improved research and supply chains, they have persisted over many years.

The recent development of the tourism industry in several Pacific island countries (Cook Islands, Samoa, and Vanuatu)—and over the longer term in Fiji—illustrates how the 'package' of institutional factors can be 'got right' in order to develop this particular 'export' industry. Long-term leases of customary land and equitable contracts with the landowners have provided security of land property rights for investors in this industry. Funds for the investment have been provided from both international and domestic sources. Law and order concerns about personal security have been privately overcome, with the resorts themselves providing comprehensive security. However, most importantly, the development of these markets has been stimulated by the opening of the international airline market by these countries.

Hopefully, PNG can benefit in the same way from the recent opening up of the international airline services. This, together with the recent land legislation providing secure long-term access to customary land, should entice investors into the tourism industry to take advantage of PNG's fantastic natural wonders.

This is a quick review of some of the 'institutional' factors that may be inhibiting supply responses to the removal of restrictions on trade, which is effectively a change in relative prices facing producers.

What is the role of trade policy?

What of trade policy itself, the various trade agreements that have been signed and those that have been proposed? It is worth reiterating Prof. Jagdish Bhagwati's comments on the question of whether preferential regional trade agreements are 'stepping stones or stumbling blocks' when he delivered the 2006 Heinz Arndt memorial public lecture at The Australian National University.

Bhagwati called the proliferation of preferential regional trade agreements a 'pox' on the world trading system. He stated that they result in trade diversion rather than trade creation. This is especially so with preferential trade agreements among small, developing countries. Moreover, they divert tariff revenue and investment from the smaller, less well-developed countries in the trading bloc to the more developed. In regards to the PICTA preferential agreement amongst the Pacific island countries, I anticipate that any benefits will mainly accrue to Fiji and PNG and the disadvantage that they will suffer will only make the other Pacific islands countries even more antagonistic towards freer trade.

Bhagwati also highlighted the fact that most countries—but most of all poor countries—have only a limited supply of the skills needed to understand, negotiate, and implement trade agreements. Therefore, the proliferation of so-called regional trade agreements—which is driven by the desires of trade Ministers and governments to sign such agreements, because others are doing it—means

that scarce skilled resources are distracted from the primary task of ensuring that the best use is made of membership of the WTO.

PNG is a member of the WTO; as well as a member of the Melanesian Spearhead Group, the Australia-PNG Trade Agreement, and APEC, among others. It has recently been negotiating the Economic Partnership Agreement with the European Union (EU) and signed an Interim Partnership Agreement with the EU because of the failure to conclude those negotiations. Also, the negotiations over PACER with Australia and New Zealand are forthcoming. PNG and Fiji—let alone the smaller island countries—have virtually nobody with high-level trade theory and policy skills and little in the way of trade negotiating skills. Their customs administrations have to concern themselves with interpreting the Rules of Origin provisions that are included in the preferential trade agreements. This distracts them from the important task of helping to facilitate trade by seeing that goods move across the wharves quickly and that the country's bio-security and human security is protected.

It is good to see that Australia is assisting the Pacific island countries to improve their understanding of trade policy and to improve their trade negotiating skills in preparation for the upcoming negotiations of PACER. It was also pleasing to hear the emphasis that Trade Minister Simon Crean (in the biannual Sir Arthur Tange address) gave to trade facilitation as part of the agreement to come from the PACER negotiations. As small, isolated countries, with limited trade negotiation skills, the Pacific island countries need to reduce their costs of trading on international markets as much as possible. Currently, PNG performs poorly in terms of trade facilitation.

The negotiations of PACER and EPA should result in closer economic integration with Australia and New Zealand and Europe—and the deeper the integration, the better. However, what about integration with Asia—those large countries close to the north with their rapidly increasing incomes and sources of cheap imports, as inputs to production processes in the Pacific islands?

Papua New Guineans worry about being 'flooded' with imports as the result of lowering trade barriers and being flooded with workers as the result of any Mode IV agreement. However, there has not been a 'flood' of imports as a result of the trade reform which has already been undertaken.

As far as expatriate workers are concerned, skilled workers should be welcomed because they are complementary to the employment of local labour. The employment of unskilled 'expatriates' is a concern, as there is likely to be displacement of local labour.

With respect to the employment of unskilled overseas workers, the pressure to raise the minimum wage back to the previous level should be resisted, as so far, such wage increases are not based on productivity increases. As increased productivity has hardly occurred, it would only lead to further interest

in bringing in unskilled overseas labour.

Conclusion

The main conclusions on trade policy are the following:

- Keep opening up the economy, such as has been done to some extent in transport and telecommunications services; and
- Give less attention to preferential trade agreements with other less-developed countries, such as PICTA and the MSG, and focus more on deep integration with larger, developed countries—starting with PACER.

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