

BTI 2016 | Papua New Guinea Country Report

Status Index	1-10	5.36	# 72 of 129	
Political Transformation	1-10	5.90	# 61 of 129	➔
Economic Transformation	1-10	4.82	# 85 of 129	➔
Management Index	1-10	4.77	# 73 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	7.5	HDI	0.491	GDP p.c., PPP \$	-
Pop. growth ¹	% p.a.	2.1	HDI rank of 187	157	Gini Index	43.9
Life expectancy	years	62.4	UN Education Index	0.376	Poverty ³	% 64.7
Urban population	%	13.0	Gender inequality ²	0.617	Aid per capita \$	89.8

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

Executive Summary

Papua New Guinea's (PNG) economy is undergoing an important transition, as new liquefied natural gas (LNG) production and exports begin. While oil/gas sector activity in 2013/14 grew, other sectors remained largely stagnant. The past three years' sharp fiscal expansion under the new Peter O'Neill government significantly curtailed fiscal room to maneuver and caused the kina to fall. This forced the government to peg the kina in early June 2014, using a trading band around the official exchange rate. By the end of 2014, it was clear that this did not really work and the kina again lost ground against the dollar. Despite this, there is still optimism about the economy, given that 2015 will be a "boom year" with an expected 21% growth rate, due to full-year operation of the LNG plant. Thus, although the overall economic growth outlook in the short run is favorable, it masks weakness in the non-oil/gas sector and in employment conditions. PNG will also not meet any of the Millennium Development Goals (MDGs) in 2015. The big uncertainty remains the unpredictable political climate. While Prime Minister O'Neill has shown political skills in surviving moves to remove him, he is increasingly skirting the law to stay in power. Poor governance and high-level corruption remain PNG's Achilles' heel.

History and Characteristics of Transformation

Beginning in the 1950s and continuing into the 1960s, Papua New Guinea's state system was imposed on thousands of ethnic and social groups throughout the country's territory. Modern political institutions developed and refined over hundreds of years elsewhere were introduced to PNG in less than 20 years. The first national elections were held in 1964 for the National parliament and a mere eleven years later, PNG was granted its independence from Australia.

The rushed transition of authorities from colonial control to independence left the state's institutions with little time to mature. These institutions were left open but also vulnerable to opportunism and manipulation by actors and agents who, by virtue of their positions in the state hierarchy, were able to pursue their own personal enrichment. In other instances, individuals approached the state system as a convenient structure to extend their patronage responsibilities and obligations and, hence, "state capture" by particularistic interests became widespread. The fact that there were overlapping forms of authority, modern and traditional, left the fate of the state at the mercy of those who were operating within its hierarchy.

The country's national constitution was also drawn up in haste in advance of independence. It was designed for a largely illiterate population that had a limited sense of national identity and whose claim to a national history was derived from developments in two separate colonial territories (Papua and New Guinea). A rather abstract national vision was formulated by a constitution that was then approved by a national consultative process whose participants were largely ignorant of the significance of statehood.

Within this transitional milieu, democracy and the rule of law was expected to take root and to follow the Westminster model of government.

Since achieving independence from Australia in 1975, Papua New Guinea has nurtured a relatively open economy. Dual in nature, the economy includes a small formal economy and a much larger informal economy in which subsistence farming accounts for the bulk of economic activity. Nearly 85% of the population resides in rural areas, and annual population growth is relatively high at approximately 2.5%. The formal sector provides a rather narrow employment base for those engaged in mineral production, manufacturing, the public sector, and service industries such as finance, construction, transportation and utilities. The rapid urban growth underway since independence is related to high levels of urban unemployment, high crime rates and other related social problems. Papua New Guinea's economic growth has relied heavily on the mining and petroleum sectors. These two sectors combined generate approximately 20% of government revenue and 60% of export revenue. Agriculture, which accounts for about one-quarter of exports, has in recent years expanded through cash crops such as coffee, palm oil, cocoa and copra. The other major export is raw timber logs.

Politics in Papua New Guinea have been marked by two distinct features, the first being the fact that only one government has completed the full term for which it was elected. The second feature has been persistent high levels of corruption. On average, governments in Papua New Guinea last no longer than three years. Of the 12 governments elected since 1977, three governments have been ousted through votes of no confidence, seven have been removed through national elections, and the remaining two ejected for other reasons. During this period, the threat of no confidence votes jeopardized cabinet stability and durability. Weak political parties in which members of parliament had little political legitimacy and were therefore susceptible to corruption. This pattern was broken by Prime Minister Sir Michael Somare, who was first elected in 2002 and again in 2007 for a second term. To facilitate stability, the government of Sir Mekere Morauta (1999 – 2002) introduced the Organic Law on Political Parties and Candidates (OLIPPAC), which makes

it difficult for members of parliament to switch parties or resign from their party. This law effectively makes it much more difficult to remove a sitting prime minister through a vote of no confidence which previously was often brought about by massive defections. The OLIPPAC itself had sections nullified by a Supreme Court ruling in 2010 on the grounds of breach of the National Constitution. Nevertheless, corruption is present at the top echelons of government and across every layer of government. It is the single biggest cause of the country's decline since independence. Huge sums of money have disappeared into the pockets of politicians and public servants or have been misspent by successive governments. There is no real political will to fight corruption.

Thus, the entire state is dysfunctional - it cannot provide basic services such as law and order, education, health, etc. Since the early 1990s, the international community has largely regarded PNG as a "weak" state. Yet, despite all the problems associated with a weak state, it has managed to avoid total state collapse. This is due to two factors. First, the country has immense natural resources, which allows the country to stay (just) afloat economically. Second, Australia has played an important role in holding up the mosaic of a "state" in PNG. For the past two decades, PNG has been the largest recipient of Australian aid anywhere in the world, to the amount of AUD 17 billion since independence in 1975.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

The state's monopoly on the use of force is established nationwide in principle but is regularly challenged in practice by criminal gangs referred to as "raskols" and tribal groups. Raskols operate mostly in urban centers and have access to high-powered weapons. These criminal gangs are also regularly found in rural areas, for example, near resource-development sites such as mines. It is important to note that criminal gangs from urban centers are highly mobile and can easily relocate to other parts of the country for brief periods when opportunities arise for them to carry out their activities there. Tribal wars are largely concentrated in the highlands and are difficult to resolve due to cycles of retribution. Other tribal wars are mostly related to land boundary issues. None of these groups are in a position to take over the country, although tribal groups are capable of taking over small territories for limited periods. During the period under review, more than 30 people died in tribal wars in Hela, a province in the highlands. The police have declared more than half a dozen areas "fighting zones." Increasingly modern weapons are used and, in some cases, the weapons used in the tribal wars have been more powerful than those used by the police.

In large sections of urban areas, the raskols are operating openly. During the review period, there were credible reports from Australia that raskol gangs were operating gun-smuggling and human-trafficking rings between northern Australia and the Papua New Guinean coast. These gangs are so powerful that the PNG police often do not dare to confront them in open battle.

With the exception of the island of Bougainville, there are no regions in Papua New Guinea where problems with state identity arise. With an estimated 830 distinct linguistic groups, the country is highly fragmented in cultural terms. While the traditional division between the highlanders and those who live along the coast still

Question
Score

Monopoly on the
use of force

5

State identity

8

exists, the country's demographic divisions are now much more fluid. Nevertheless, derogatory stereotypes of highlanders being violent and "backwards" persist.

As they are geographically as well as culturally closer to the Solomon Islands than mainland Papua New Guinea, the population of Bougainville tried unsuccessfully to gain their independence in the 1970s. In 1989, a war of secession broke out and in 2004, the Papua New Guinea government unveiled a new constitution for the island, granting Bougainvillians greater autonomy. In the period under review, an autonomous provincial government moved to separate itself further from the rest of PNG, indicating that the long-term plan is independence. One such move is to move the time one hour ahead from the rest of PNG, called Bougainville Standard Time.

Although the state is secular, the constitution does refer to PNG as a Christian country. Religious leaders from the Protestant and Roman Catholic churches and smaller Christian denominations remain influential and their influence can be seen in the way some individual church members supported candidates in the 2012 national elections. Almost all political parties in the 2012 elections claim to be guided by Christian principles. The political process is secular and freedom of religion, by and large, is respected. Because the overwhelming population is Christian (more than 90%), policymakers take church leaders' opinions seriously. Several priests have resigned from their duties with the Roman Catholic Church to pursue a full-time political career, the most prominent example being John Momis, president of the Bougainville Autonomous Government.

No interference of religious dogmas

8

There is no manifestation of political rivalry that shows a religious divide. However, reservations have been expressed against other religions, Islam in particular. There is one mosque in Port Moresby and about 300 Muslims in the country. Despite this, some Christian leaders openly called for PNG to be declared a Christian state.

Most analysts consider PNG a weak state in which the state apparatus cannot implement even the most basic policies. The government's most fundamental operational machinery is either dilapidated or nonexistent in many rural areas and the highlands, where tribal conflicts continue. Part of the problem is transportation. There are no roads to the highlands. In the past two years, the inability of the state to provide basic services has remained unchanged. The law and order situation has remained largely the same. The government regularly talks about using the army to do police work. Healthcare is not properly provided beyond the vicinity of major towns and provincial capitals. In the period under review, several hospitals were shut down due to insufficient money. In one telling incident, refugees at Manus Islands (operated by the Australian government) refused to be taken to the general hospital, arguing that healthcare facilities were better in a refugee camp than the government hospital.

Basic administration

4

There are also cases of poorly designed laws that have curtailed good governance. Changes made to the provincial government system in 1995, which pushed many of the state functions to provincial governments, further weakened the presence of the state mechanism in peripheral areas, since many of these provincial governments have no money; nor have they received additional funding from the central government.

What has become increasingly evident since the 1980s has been the increasing politicization of the civil service. The state's presence naturally has often been felt through the civil service. Thus, apart from badly designed legislation that curtails the "reach" of the state apparatus, there is also a weakness on the part of society at large to keep elected leaders in check, since quite often laws are passed to suit political conveniences of the moment. In this regard, traditional animosities expressed in tribal clashes – which are otherwise often confined to specific locations of the country – are exacerbated by poor political decisions.

2 | Political Participation

Under the constitution, Papua New Guinea is a parliamentary monarchy with Queen Elizabeth II as the head of state. She is represented by a governor-general, but executive power lies with the prime minister and the cabinet. All members of the cabinet must be elected via a complicated Limited Preferential Voting (LPV) process. There have been both universal suffrage and regular elections since independence. Elections are free but not fair. In the highlands and certain coastal regions, massive vote buying, ballot rigging, clan voting, violence, intimidation and cheating are widespread. The main difficulties with conducting free and fair elections in 2012 (as in previous elections) were the PNG Electoral Commission's incompetence and instances of political interference, and insufficient resources and logistical arrangements. Such problems are compounded by the fact that voters in some electorates – with or without the support of candidates – are bent on bending the electoral rules from the outset and throughout the election process in order to secure favorable outcomes. Another major problem is bribery - either in cash or goods, or both. This is a common practice in non-urban seats. The biggest problem is persistent violence in every election, especially in the highlands. It is common for well-resourced candidates to arm their supporters with high-powered weapons to protect themselves and also to intimidate their opponents. Gun battles associated with elections are common in the highlands. The problem was also evident in the recent 2012 national elections. During the recent national elections, more than a dozen people were killed in election-related violence. In Tangu and Biamb villages, near Madang, cult killings disrupted the voting process after at least seven people were killed and fell victim to cannibalism. There were incidences of underage voting,

Free and fair
elections

6

bribery and hijacking of ballot boxes. An official from the Election Commission was arrested for fraud and ballot tampering.

Despite this, almost all transfer of power took place peacefully after election results were announced. The military and the police have generally refrained from interfering in politics. The other positive aspect of elections in PNG is a free media. The media generally reports from all sides in a fairly objective manner.

While elected leaders have the constitutionally mandated power to govern, this power is in practice often compromised by clan and regional loyalties, powerful business groups and interest groups such as landowners and the military. The problem is compounded by high levels of corruption among senior politicians and a corrupt and inefficient bureaucracy that often lacks the capacity to carry out government decisions, or in some cases, is used by powerful individuals (referred to as “Big Men”) to subvert government policies. In January 2012, a group of officers loyal to the former prime minister, Michael Somare, tried to stage a coup by taking over the main military base in Port Moresby. However, the coup was put down in 48 hours. There are also persistent rumors that Asian businessmen have undue influence over the government. In a famous case in 2013, an Indonesian businessman, Djoko Tjandra, was stripped of his PNG citizenship. He had been issued a passport under the name Joe Chan, despite being wanted by Interpol and the Indonesian government.

Effective power to govern

5

There are no restrictions on asserting the constitutional right to assemble and establish associations. NGOs play an active role in voter education and civil society. Political and civil organizations such as trade unions can – and do – form freely. There is no law that restricts the work of NGO or civil society groups and no registration is required to establish a civil society group or NGO. During elections, it is common for NGOs to take an active part in voter education, although due to the security situation and violence, such work is mainly confined to urban areas. In the most recent elections, NGOs such as Transparency International (PNG) and Caritas PNG spearheaded a nationwide program to build integrity in the electoral processes through civic awareness.

Association / assembly rights

10

There are no restrictions on the freedom of expression for individuals or the mass media. The media often exposes corruption and criticizes national leaders. However, the business interests of media outlets’ owners often restrict content. “The National” daily, which is owned by the logging giant, Rimbunan Hijau (RH), never prints a negative story about RH or the logging industry in PNG. However, the ownership structure of the media is diversified, and there are other newspapers and electronic media that can provide balanced information. In the 2014 Press Freedom Index published by Reporters Without Borders, PNG was ranked 44 out of 179 countries. While it is true that there is freedom of expression for people and the mass media, there is another side to media work that is often overlooked in PNG: there is hardly any media coverage geared towards exposing wrongdoing. Investigative reporting is

Freedom of expression

9

not a significant factor in the country, not because it is banned or restricted, but because reporters and like-minded people are fearful of “payback” or revenge attacks. During the period under review, two television journalists with the local station EMTV were assaulted by the police. In 2013, a journalist was assaulted by the owner of Bismarck Maritime while writing a story about migrant workers in the company.

Online and social media give even greater freedom to users. Unfortunately, the penetration rate of the Internet in PNG is low and confined mainly to the urban centers. There are blogs and Facebook pages promoting all political views and there are no efforts to censor whatsoever. Although many of these postings (especially during election times) may be deemed defamatory, thus far no defamation cases have arisen from online content.

3 | Rule of Law

There are no formal constraints on the separation of powers between key institutions and there is a system of mutual checks and balances in place. However, the government of Peter O’Neill has sought to weaken checks and balances. For example, he refused to accept a Supreme Court ruling that former Prime Minister Somare was the rightful prime minister in December 2011. O’Neill was installed as prime minister by lawmakers in August 2011, when Sir Michael Somare, 75, underwent a series of heart surgery operations in Singapore. The Supreme Court ruled that Somare had not left the post. O’Neill later pushed through the Judicial Conduct Act (2012), which allowed the government to sack judges; it was later repealed. O’Neill has also refused to step down, despite being charged with corruption in 2014. Instead, he sacked PNG’s attorney general, police commissioner, and the head of the country’s anti-corruption task force, Sam Koim.

The weakness of the separation of powers in PNG stems from two factors: (a) the strong reciprocal relationship between members of parliament and voters (often called the Wantok system), and (b) the unicameral parliament. The majority of the parliamentarians prefer to be in government rather than the opposition so that they stand a better chance of accessing resources for pork barrel politics. This explains the dominance of the executive over parliament.

More than 10% of members of parliament in PNG were investigated for corruption in 2014, although most believe this figure to be at least 70%. In effect, corruption among members of parliament renders the system of checks and balances almost impossible to implement.

The one bright spot is the judiciary. Despite some evidence of corruption, on the whole it has maintained its role in checking the powers of the executive. In the period under review, the PNG National Court sentenced Paul Tiensten, a former senior

Separation of
powers
6

minister and incumbent parliamentarian, to nine years imprisonment with hard labor for misappropriating \$4 million of public funds.

As in previous years, the judiciary has been hampered by a lack of resources. There are persistent reports of corruption at the lower levels, such as the magistrate level. Several magistrates have been charged with corruption in recent years. Many of the best legal minds stay in the private sector as the public sector does not pay well. Although, in general, the judiciary is free of unconstitutional intervention, the O'Neill government tried to assert executive control by passing the Judicial Conduct Act (2012), which allowed the government to sack judges. It has been repealed.

Independent
judiciary
7

Despite poor resources and lack of talent, the judiciary on the whole is largely independent, with all sections of society, except perhaps parliament, agreeing that an independent judiciary is good for the country. The judges often ruled against the government. In the period under review, as mentioned earlier, Paul Tiensten, one of the most powerful politicians in PNG, was found guilty of corruption. The judiciary also issued a warrant for the arrest of the prime minister on charges of corruption (although it was never executed by the police).

Many senior politicians continue to escape prosecution for corruption and abuse of power. Under PNG's Leadership Code, the moment an elected leader resigns, s/he cannot be prosecuted for misconduct, although they can face criminal charges if cases are put together against them. The reality is massive collusion between members of parliament and public servants who can cover for each other. Many senior civil servants who misused public money in the past two years were never charged.

Prosecution of
office abuse
4

One significant positive change was the creation of an anti-corruption task force in 2011. Unfortunately, the task force was immediately dismantled when it charged the prime minister with corruption in 2014. Although Parliament approved the creation of an Independent Commission Against Corruption (ICAC) in Feb 2014, the government has yet to pass related organic laws in order for the ICAC to be formally established. There is widespread agreement that the government will not pass the related laws.

PNG citizens enjoy full civil rights under the constitution but, in reality, marginalized groups such as LGBT groups, prisoners, women, children, people living with HIV/AIDS and people with physical disabilities are often openly discriminated against by society at large. Many of these groups face social discrimination, as the population on the whole is conservative and Christian values play an important role in daily life. For example, members of the LGBT community do not openly display their sexual orientation; nor are there any advocacy groups advancing their rights.

Civil rights
5

There are numerous reports of police regularly beating up suspects and raping women held in custody. Despite reports commissioned by the government about discipline in the police force, nothing has been done. A woman was burned alive because she was

accused of using sorcery in Western Highlands. In the highlands, the army and police and raskol gangs regularly set up “security” roadblocks to extort money from travelers.

In 2014, PNG amended legislation to extend the death penalty to cover more criminal offences. Previously, the death penalty was applicable to treason, piracy and willful murder.

The poor state of civil rights in PNG can be seen by the fact that the Australian government has established a refugee processing camp in Manus.

4 | Stability of Democratic Institutions

In the period under review, all the key institutions of state were compromised by or experienced interference from the executive. In 2014, for example, an anti-corruption task force established by Prime Minister O’Neill began charging senior bureaucrats with corruption. In June 2014, the taskforce issued a warrant for the prime minister himself on charges of corruption and abuse of power. Within 24 hours, the prime minister announced that the task force was disbanded and sacked the deputy police commissioner and the attorney general. The police commissioner, the nation’s top police officer, was also removed and a new police commissioner appointed. The new police commissioner held a press conference to say that he would not act on the arrest warrant. The head of the disbanded task force was forced to flee for his life to Australia. This simple example shows how three key institutions of state - the executive, the judiciary and the police - cannot function independently and can be compromised by a powerful prime minister.

Performance of
democratic
institutions
4

Almost all Papuan New Guineans accept the legitimacy of institutions, despite knowing that corruption is rampant and that politicians are involved in abuses of power. This faith in democratic institutions is reflected in the huge number of candidates in the 2012 national elections and earlier elections. The relevant political parties, economic actors, societal organizations and government bodies are committed to democracy, though it is obvious that democracy is primarily understood as elections only. This commitment to democratic institutions also includes the military and the police. All attempted coups – the most recent being 2012 - gained little support from enlisted soldiers and the public.

Commitment to
democratic
institutions
7

Democracy in PNG is a hybrid national political culture that has evolved over time. An example is the wantok (“one talk”) system, in which one’s obligation to a clan overrides almost all modern rules and regulations. The wantok system defines the way the government exists and state institutions operate. It is this political culture that offers legitimacy to the country’s political practices. It does not mean that the practices are always beneficial, lawful and in the public interest in the context of a

modern political system. It simply means that they are the way things are done, understood and sometimes condoned – the PNG way of doing things. An example is nepotism: Appointing one's own clan members to a job is seen as a natural thing to do. Helping your family and clan with resources when you are a leader is seen as a prerequisite and confers recognition, credibility and legitimacy as a leader. In many Western countries, political nepotism is considered corrupt. Thus when modern laws collide with traditional rules, modern laws are often set aside.

The weakness of public agencies to impose the will of the state in turn reinforces the credibility and even public acceptance of these extra sources of authority.

5 | Political and Social Integration

The PNG party system has been fragile since independence, but it became unstable after the Bougainville crisis in the 1980s. Political parties tend to be driven by personalities and regional or clan ties. All political parties in PNG lack organization, a political philosophy or any real public policies. This state of affairs has resulted in a high level of voter volatility and a high attrition rate of incumbent parliamentarians (well above 50% for the last four elections). It is not uncommon for politicians to form their own parties even if they are the only elected representatives. The Organic Law on Political Parties and Candidates (OLIPPAC), aimed at bringing stability to the incumbent government by preventing members of parliament from party-hopping and forcing a vote of no confidence against the prime minister, has not stopped members from defecting in the past two years. A 2014 proposal would strengthen the OLIPPAC by allowing the registrar of political parties to access to the bank accounts of individual members of parliament and political parties. Thus far, parliament has rejected the proposal.

Despite the OLIPPAC, almost all PNG governments since independence are coalition-built after the electoral results. The current O'Neill government is no exception. Many supporters of the government are in fact defectors from other parties. As mentioned earlier, the need to be in government to access resources is a powerful incentive to defect. Major defections during the period under review include Madang Governor Jim Kas, Huon Gulf Member of Parliament Ross Seymour and even the opposition leader Sam Basil, all of whom joined the governing coalition. By the end of 2014, the opposition was left with just three of 111 parliamentarians.

Hence, it is clear that the OLIPPAC has failed in its stated aim to deter defections in order to promote stability. Nevertheless, one could argue that all the defections in the period under review are positive given that they have created larger political parties. One of the key goals of the OLIPPAC was to establish larger political parties, rather than many smaller parties.

Party system
3

In sum, the main problem with political parties in PNG is the combination of weak ideology and the lack of proper party machinery. Almost all major political parties in PNG are centered on a single “big man” or on a single region. Members elected to parliament try to maximize personal benefit through corruption rather than looking after the long-term interests of the country. Public policy is not a priority for political parties. Thus, defections and coalitions of convenience are common methods used to get into power, and this in turn causes political instability and further weakens the party system.

Although there are plenty of interest groups and civil society organizations (CSOs) in PNG, only a handful of these have real access to power and policy-making. The powerful interest groups are those connected with business groups or commerce, based around a region or province and Christian groups. Important groups such as women’s rights organizations are often left out of the decision-making process. A major problem for interest groups, faced by individuals and by rights organizations alike, is the lack of support from members of the wider public. Interest groups are frowned upon by the government and its representatives and often simply lack the skills to properly air their views on issues. In the period under review, the CSOs tried to overcome their weakness by holding a PNG National CSO Round Table in Port Moresby. However, there is little evidence that PNG CSOs are able to come together in a coherent manner unless they are supported by donor agencies.

Interest groups
5

Consent to Western-style democracy among citizens is high, and the constitutional framework is fully accepted by most segments of society. Surveys done prior to elections showed the majority of those surveyed supported the democracy under the principles of one-person-one-vote, regular elections and a Westminster-style government.

Approval of
democracy
7

At the same time, however, it is clear that outside the major urban centers, people are indifferent to the everyday functions of democracy. For most people, democracy simply means elections. In recent years, increasing numbers of PNG intellectuals have started to argue that Westminster-style democracy cannot work in the country given the incompatibility of its strong community-based traditions and modern democracy’s individualistic approach. They called for a hybrid form of democracy called “the Melanesian way,” although it is unclear what this would entail. It appears at the most basic level that Melanesian democracy would mean traditional leadership based on culture and kinship. In the period under review, the significant change is the role played by social media. Although traditional media continues to be important, the proliferation of mobile phones has given Papua New Guineans, including those living in rural or remote areas, the ability to access information and therefore take a participatory approach to democracy. It is getting harder and harder to hide the misdeeds of political leaders.

There is a low level of trust among the population. Existing trust is still largely based on clan and tribal loyalties called the “wantok” (one talk) system. Cultural norms such as “wantok” and “payback,” which require entire clans or tribes to retaliate against another when a clan member is injured or harmed, supersede any form of civil society norms. Payback activities and low levels of trust can be seen as symptoms of social dilemmas.

Social capital
4

NGOs and CSOs are a new phenomenon in PNG society. In urban areas, on issues such as deforestation, some level of trust and working together for the common good can be seen. There is virtually no trust when it comes to politics.

Women’s and environmental groups constitute the most successful indigenous self-help organizations. The lack of trust is also due to general disillusionment with the role of the government and its inability to provide basic services and development. Still, traditions of self-organization and cooperation are common in many provinces of the island: people in rural areas assist with community services, which include a range of activities such as maintaining law and order, assisting the elderly and church activities.

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

Poverty and social exclusion are quantitatively and qualitatively extensive, and they are structurally embedded. PNG ranks 157th out of 187 countries on the 2013 HDI. The Gini index for PNG is estimated to be 50.9. The World Bank estimates adult literacy rates of 57% for males and 63% for females. A joint Australian-PNG report suggested that all the universities in the country are underperforming. Unemployment is estimated to be higher than 50% and more than 80% of the population relies on subsistence farming or the informal economy for their daily needs. The World Bank estimated that in the period 1993 to 2002, approximately 57.4% of the population survived on less than \$2 a day, suggesting that 70% of the population live below poverty line. Current estimates are roughly similar. Infant mortality is ten times higher than in developed countries, and the prevalence of HIV and AIDS is increasing. The latest HIV/AIDS surveillance report says that about 20% of the male population in the highlands is HIV positive or exposed to HIV/AIDS through casual sex. Efforts to eradicate poverty have been hampered by corruption and poor governance. Moreover, ineffective policies, especially in the agricultural sector, have failed to assist the bulk of people living off the land. Coffee production by smallholders, which used to be a major cash crop in the highlands, has fallen on hard

Socioeconomic
barriers
3

times. The main causes for this are: law and order, land disputes, lack of basic coffee farming skills, lack of quality control, no government help and poor rehabilitation of existing coffee trees. Although the country has experienced a construction boom and mineral resources boom in the past few years, it has had little effect on the poverty rate. Many of those who benefited from the construction boom are foreign workers who fly in to work on sites, while the major beneficiaries of the mineral resources boom are the mining companies and selected politicians.

Women suffer significant discrimination, mainly due to a male-dominated culture. It is not uncommon for men in PNG to regard women (and children) as their property. PNG ranks 135 out of 187 countries in the Gender Inequality Index (GII). PNG will also not meet any of the Millennium Development Goals (MDGs) in 2015.

Economic indicators		2005	2010	2013	2014
GDP	\$ M	4866.0	9716.1	15413.2	-
GDP growth	%	6.3	7.7	5.5	-
Inflation (CPI)	%	1.8	6.0	5.0	5.2
Unemployment	%	2.6	2.4	2.1	-
Foreign direct investment	% of GDP	0.7	0.3	0.1	-
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ M	539.4	-633.0	-	-
Public debt	% of GDP	48.1	25.6	34.0	35.6
External debt	\$ M	1895.9	5965.0	21733.1	-
Total debt service	\$ M	307.8	811.7	4442.8	-

Economic indicators		2005	2010	2013	2014
Cash surplus or deficit	% of GDP	-	-	-	-
Tax revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	-	-	-	-
Public expnd. on education	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	3.1	2.5	3.6	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	0.6	0.5	0.5	-

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

7 | Organization of the Market and Competition

Market competition has a solid institutional framework, but the rules are not consistently or uniformly applied to all market participants. PNG's small economy means that there are oligopolies, such as Trukai (rice supply), and firms supported by powerful politicians, which often receive favorable treatment from the government.

Market-based
competition
5

Another prime example is the state-owned company Telikom, which uses its status to create barriers for competitors – particularly in the mobile phone and internet-provider sector. There are also significant barriers to new market entrants, such as the high costs of establishing a business, breakdowns in law and order, high banking costs, high Internet costs, bureaucratic red tape and corruption, all of which interfere with the functions of a free market.

The government's own Investment Promotion Authority (IPA) is jokingly nicknamed the Investment Prevention Agency by the foreign business community. The omnipresence of corrupt political leaders and an incompetent and corrupt bureaucracy often result in unfair competition by businesses that are willing to pay "facilitation money." Commissions of inquiry have found numerous instances of public tenders being awarded to companies or individuals who have bribed officials. Large and well-established companies have a significant advantage over newcomers. In recent years, there has been a trend for major companies to buy their smaller competitors; for example, the popular "Stop-N-Shop" supermarket chain was bought by CPL Group, which runs "City Pharmacy" stores inside Stop-N-Shop stores.

In the period under review, market conditions have deteriorated as the big companies have consolidated their hold over the economy. For example, in 2014 Telikom PNG bought Internet service provider Datec PNG, which means there are only three

Internet service providers (ISPs) left in the country. In late 2013, Digicel PNG purchased Daltron's ISP business.

There is some evidence to suggest that more and more people are moving towards the informal economy because of the significant barriers to establishing a business. The World Bank's Ease of Doing Business Index (2015) ranks PNG 133 out of 189 countries. An example given in the report is that it takes 42 working days to connect electricity to new business premises in the capital Port Moresby. PNG Power Ltd. has a monopoly on providing power to the nation's capital.

There were some positives. The Investment Promotion Authority (IPA), which administers the PNG Companies Act, business name registrations and foreign investor business certification, announced that registry searches of company records, business names and foreign enterprise certification to undertake business in PNG may now be conducted online. Previously, all these searches were done by hand, which was very expensive.

Although there is a formal office of Independent Consumer and Competition Commission (ICCC) in place to regulate against monopolistic behavior, the small size of the PNG economy and historical circumstances have ensured that some of the larger companies continue to operate as oligarchies and monopolies. For example, the state-owned enterprises PNG Power (electricity), Telikom and Eda Ranu (water utility) hold virtual monopolies in their respective sectors. Many of these large companies have strong political connections to protect their position. In the financial sector, three banks, Bank South Pacific (BSP), Australia New Zealand (ANZ) Bank and Westpac PNG, control more than 90% of the financial market. BSP alone controls at least half. The present ICCC was based largely on the Australian framework, with its emphasis on promoting competition and fair trading and regulating national infrastructure to make markets work for all consumers.

Anti-monopoly
policy

5

In August 2013, the PNG Takeovers Code was amended to include a "national interest" test, whereby the Securities Commission has power to "issue an order preventing a party from acquiring any shares" if the Securities Commission views that such acquisition or takeover is not in the national interest. It subsequently exercised its powers under this provision to prevent Kulim Malaysia Berhad from increasing its share of New Britain Palm Oil Limited from 49.97% to 68.97%. Observers are in general agreement that this action was the exception rather than the norm, and there were political issues behind it. On the whole, action against monopolistic behavior by firms is tolerated, especially if they are state-owned enterprises.

The government encourages foreign trade, especially with those states participating in the Melanesian Spearhead Group (MSG) Preferential Trade Agreement (PTA), which includes Vanuatu, Papua New Guinea, the Solomon Islands and, recently, Fiji.

Liberalization of
foreign trade

6

However, bureaucratic red tape and the high cost of transportation between the island states constitute significant barriers to free trade and foreign investment. In practice, this means large and well-established companies have a distinct advantage over new entrants and small companies. Despite its public pronouncements, the country is not foreign-investor friendly. A maze of regulations and paperwork must be navigated before a foreign enterprise can start operations in Papua New Guinea. The Investment Promotions Authority (IPA), supposedly a “one-stop” center for foreign businessmen, is often derisively referred to as the Investment Prevention Authority due to its slowness and bureaucratic maze.

The country’s rugged topography and lack of roads mean that the cost of building and maintaining infrastructure is extremely high. No roads link the lowlands with the highlands. Many parts of the country are only accessible by air or by ship.

The country’s leadership is committed to free trade and plans to join the Trans-Pacific Partnership (TPP) and the Australian-initiated Pacific Agreement on Closer Economic Relations (PACER) Plus. Both are still ongoing and, if successful, will, in theory, see a major boost in PNG’s foreign trade. Many in PNG view these agreements as important, but they fear that local businesses will be worse off when foreign companies, with more capital and technical expertise, are allowed a free hand in the economy.

Despite the ongoing TPP and PACER Plus negotiations during the period under review, progress was made internally. Approximately 75% of all imports to PNG are now duty-free. The government embarked on a tariff-reduction program in 2011 and tariffs were going to be reduced by 5% up to 2018. The first cut took place on 1 January 2012. The next cuts were announced for 1 January 2015 and 1 January 2018. In terms of customs procedures and trade facilitation, PNG has completed the requirements for the accession to the Revised Kyoto Convention.

For the foreseeable future, PNG’s foreign trade will be dominated by MSG countries and Australia. The longstanding Papua New Guinea-Australia Trade and Commercial Relations Agreement has ensured that Australian companies remain the largest cohort among foreign business entities. Australia’s role as former colonial power has ensured that Australian companies have a distinct advantage in doing business.

The banking system is sound on the whole. The central bank, the Bank of PNG, follows international standards and pursues best practices. The BPNG is the regulatory authority over all financial institutions in PNG. The BPNG also prosecutes any breaches to the regulations. The Governor of the Central Bank is appointed on merit and is largely free from political interference. The bank is widely seen as competent and effective. However, given that there are only four privately operated banks in the country, there is an unofficial duopoly at work in the banking system. One of the four banks, Bank South Pacific (BSP), controls more than half of the

Banking system

5

market and is the only bank with branches throughout the country. It thus holds an unofficial monopoly on rural banking. BSP is also arguably the only bank willing to take on the risks involved with investing in rural areas, particularly where banking is exposed to criminal activities. The other three banks, Australia New Zealand Bank (ANZ), Westpac PNG and Maybank Papua New Guinea (a Malaysian bank), concentrate mostly on business clients and can be found only in the country's urban centers.

Banks in Papua New Guinea are inefficient. For example, local checks require three working days to clear. Most businesses still prefer cash. Internet-banking facilities are only available to a few. Credit cards are not widely accepted.

By the end of 2014, the ratio of nonperforming loans to total loans was 2.1%, while the ratio of nonperforming loans to total assets was 0.9%. The capital adequacy ratio for the banking sector was 28.7%, well above the minimum requirement of 12%. The return on assets was 3.0% and return on equity was 42.6%. These indicators show the soundness of the financial system in PNG.

One major initiative during the period under review was to increase the number of women with bank accounts; another increased access to financial institutions in rural areas.

With only 19 companies listed the Port Moresby Stock Exchange (POMSOX) is small, and all of its key counters have dual listings on the Australian Stock Exchange (ASX). Market liquidity remains the key problem, with a limited number of local players and international players preferring to buy via ASX. There are no restrictions on foreign capital entering and exiting the POMSOX. Many of the large players use the dual listing to move money to Australia. What is telling is that there were no new companies listed on POMSOX in 2014. By contrast, Cue Energy was delisted from POMSOX due to lack of trading.

8 | Currency and Price Stability

During the period under review, the Bank of Papua New Guinea maintained a tight monetary policy primarily aimed at curbing inflation and maintaining stability in the exchange rate, as well as the macroeconomic environment. The central bank is independent of the government, although the majority of its board members, including the central bank governor, are appointed by the government. Hence it cannot be totally independent.

Due to the political uncertainty, there was a general lack of confidence in the kina. During the second half of 2013, the kina fell 13.7% against the dollar, from \$0.4438 to \$0.3830. In mid-June 2014, the government ordered the central bank to peg the kina to the dollar to stop a steady decline in value. The “managed float” allows banks

Anti-inflation /
forex policy

6

to only trade the kina within 75 basis points on either side of the reference rate, pegged at \$0.4130. Despite the introduction of the trading band, the kina had depreciated by 6.6%, from \$0.4130 (K1.07) to \$0.3855 (K1), by the start of 2015. This indicates a lack of confidence in the foreign exchange interbank market.

According to the World Bank, inflation hovered at 5% in 2013 and about 5.3% in 2014. If the kina continues to fall, the inflation rate will go up, given that many household consumables are imported. The ability of the Central Bank to control the exchange rate is limited, as mentioned above, as it is politics driving the rate of exchange

The government and central bank policy of macrostability is aimed at attracting foreign investors and maintaining stable prices. The central bank's independence has been crucial to achieving these goals. Public debt is estimated to be 41.6% of GDP in 2013.

The weaker revenue collections - particularly from mining and petroleum taxes - have the budget deficit for 2014 in the region of 6.9% of GDP. As a result, public debt rose to 37.1% of GDP by the end of 2014, up from 22.0% at the end of 2011. This debt exceeds the government's own debt ceiling target of 35% of GDP. High government expenditure, combined with the kina weakening, have contributed to inflation. Consumer prices rose 6.0% by the end of 2014.

In the period under review, most observers take the view that government's financial position in the past two years was not a concern because of the massive boost to the economy in 2015 due to the LNG exports.

9 | Private Property

Property rights are well-defined legally. However, a generally weak bureaucracy and the state's weak monopoly on the use of force also mean that in some areas – especially the more remote highland territories, where there are no functioning public institutions – legal property rights cannot be enforced by courts or state authorities.

Corruption has been rampant for many years in the Department of Lands, which has resulted in a lot of prime land in the nation's capital and other urban centers being taken over by individuals (including former members of parliament) with connections to the government and big companies, some of them foreign-owned. The previous Somare government had embarked on a SABL (special agriculture and business leases) program, which reportedly saw corporations take over 5 million hectares (approx. 11% of PNG's total land area) of customary land. A Commission of Inquiry (COI), established in July 2011 to examine the granting of Special Agriculture and Business Leases (SABLs), delivered its findings early in 2013, detailing individual reports on 42 of the 77 SABLs it was tasked to review. Of the 42 leases examined,

Macrostability
5

Property rights
7

only four were upheld as “problem free”. The rest fell under one of the following recommendations: to be revoked; surrendered and renegotiated; suspended or subject to further investigation because of serious irregularities; or declared null and void by the National Court. A SABL is a mechanism whereby customary land, which represents 97% of the land in PNG with ownership not recorded under any land titling system, is leased to the Independent State of Papua New Guinea on a lease-back arrangement. The lease-back is to a representative entity of the customary landowners for the purpose of on-leasing for agriculture and business purposes. The uncertainty surrounding the likely and then published findings of the SABL COI has led to ongoing delays in processing many SABL-related dealings in the PNG Lands Department. The PNG Government is looking to reform customary land ownership legislation in the light of these findings.

A major change in the period under review was that the establishment of the first PNG Property Security Register progressed in 2013. This electronic system will be much more secure than the present manual system, and is expected to be fully operational in 2015.

Private companies constitute the backbone of the economy, but major utilities are run by state-owned companies such as Eda Ranu (water supply), PNG Power (electricity) and Telikom (communications), which hold a virtual monopoly in their respective sectors. Some private companies, such the rice importer Trukai, also hold virtual monopoly power in their sectors. Private companies are viewed as engines of growth and are given legal safeguards. The privatization of state companies often suffers from political interests. State-owned enterprises in PNG have powerful trade unions. Many of the country’s current political leaders were involved in creating these businesses and are inclined to argue for their continued preservation, regardless of their performance. The national airline, Air Niugini, is one such example of an enterprise that has received economic and political support despite losing money consistently.

In the period under review, most new business were connected to the multi-billion-dollar PNG-LNG pipeline project. Several new energy companies, such as Puma Energy, came into the market to serve the needs of the new PNG-LNG project.

10 | Welfare Regime

There is only a rudimentary social security net in PNG. The government does not provide unemployment or related benefits. Traditional/cultural safety nets still exist. However, the tradition is practiced more often in rural areas than in urban areas, where the costs of living sometimes strain the fibers of such safety nets. The cultural norms involved in various social groupings – including nuclear/extended families, clans and wantok (a pidgin term, literally “one talk”) – require that weaker members

Private enterprise
6

Social safety nets
3

be looked after by these social safety networks. All official programs helping those in need are undertaken by NGOs funded from foreign sources, rather than the government. The Australian government's overseas development aid program, AusAid, plays a major role in education, poverty and rural health programs in PNG. The majority of the population do not have access to proper healthcare, clean water or electricity. Estimates vary, but the consensus is that less than 50% of the population has access to healthcare, education, electricity and clean water. Major hospitals around the country are routinely shut down or are forced to scale back services because they have not received their budget allocations on time. Hospital shutdowns due to unpaid staff or unpaid electricity and water bills are not uncommon. Many hospitals rely on foreign aid to fund equipment and medicine.

In the period under review, three major hospitals (Tari, Madang & Port Moresby) experienced temporary shutdowns. Working adults in full-time employment are required to pay into a provident fund that is based on regular contributions from both the employee and employer. The government has passed laws to allow private provident funds to be established after money in the national provident fund (NPF) was stolen by politicians. Despite a report detailing who stole the money, no one has gone to jail over the NPF fraud. The number of these private funds has grown to seven over the past two years. However, it is widely acknowledged that the money saved in the provident funds will not be enough to provide for retirement pensions.

Although there are equal opportunity laws, large sections of the population face open discrimination. Women in particular are discriminated against in all strata of society. Their access to education, medical care, employment opportunities and public office are limited, and women are rarely protected from domestic abuse. It has been estimated that only about half of eligible female students actually attend high school. The national literacy rate is only about 60%. In the political arena, where women's participation is marginal, women suffer widespread discrimination and generally find it difficult to win elections. In the 2012 national elections, three female members of parliament were elected, up from only one female member of parliament in the previous election (2007). Despite this, women issues have not made any headway.

Cultural discrimination against women in many parts of PNG is based on conservative beliefs, which hold that men are born to lead and that women should look after the family and the household. In the highlands, where such beliefs are deeply rooted in the cultural environment, women in remote communities are subject to extreme social control. However, this set of beliefs is also prevalent among the educated ruling elite, and it is common to hear of members of parliament and other senior officials who have beaten their wives. While several ministers have been openly accused of domestic violence, most of these reports are not investigated by the police. Indeed, domestic violence is widespread. A 2013 study by Médecins Sans Frontières found that 70% of women in Papua New Guinea will be raped or physically assaulted in their lifetime. PNG has some of the worst health indicators in

Equal opportunity
3

the world for women. The doubling of deaths in childbirth in the last decade suggests conditions are worsening.

Poverty contributes to gender discrimination, since parents are more willing to spend limited resources on educating males rather than females. The undervaluing of women can be seen in tribal wars. When a woman is killed, compensation is typically \$770, against \$1,930 for a man.

11 | Economic Performance

The economy proved fairly resilient in the period under review, largely due to the confidence created by the completion of the PNG-LNG (liquefied natural gas) pipeline in 2014. LNG exports are expected to boost overall GDP growth to 20% in 2015. However, growth of the non-resource economy has slowed since 2012, mainly as a result of the PNG-LNG project moving from construction to production. While exports from LNG will eventually provide revenue to the state, they are unlikely to be felt in the short term. GDP growth rose to 6.0% in 2014 and is expected to soar to a record 21.0% in 2015, entirely driven by exports of LNG. LNG exports commenced in 2014, but 2015 will be the first full year of production. Growth outside of the mining and petroleum sectors slowed to just 1.6% in 2014. The strong growth achieved outside of resource extraction in recent years - largely spillover from LNG pipeline construction - has dissipated. Construction contracted by 6.4% in 2014, while activity in transport and logistics, wholesale and retail trade, and financial services appears likely to slide from the highs recorded over the past three years.

Despite positive gains from LNG exports, the structure of the non-oil/gas sectors of the economy did not change in the review period; 90% of the labor force works in non-oil/gas sectors. Real unemployment remains stubbornly high, estimated to be about 50% of the adult labor force, although formal unemployment is about 2.5%. The surge of money associated with the construction of the LNG pipeline did not bring any real benefits to the unemployment situation.

The non-oil/gas sector did not perform well in the period under review. Forestry, agricultural and fishery activity currently accounts for one-third of the economy and remains the principle livelihood of the vast majority of Papua New Guinea's citizens. International prices for PNG's main agricultural exports remain volatile. Coffee prices jumped 57% from December 2013 to June 2014. Prices for other major agricultural exports consolidated earlier gains, with copra rising by 10% in the first half of 2014 and cocoa by 12%. On the downside, the production response to these higher prices has been limited by structural constraints like weak transport and logistics networks, a cocoa pod bora infestation, and aging coffee and tea plantations that require replanting. The government's decision to peg the kina in mid-June 2014, shooting the currency's value up by 20%, caused produce prices to spike. Overall, in

Output strength
7

the period under review, the agricultural sector contributed less than 2% to GDP growth.

The current-account deficit has widened sharply in recent years, accounting for 107% of GDP in 2013 and 2014, largely as a result of increased imports and income outflows related to the LNG project, which are funded by corresponding FDI and medium- and long-term loans. The deficit is expected to decline quickly and turn into a surplus in 2015 when the LNG will be in full operation.

The O'Neill government adopted an expansionary fiscal stance in 2013, leading to a fiscal deficit of 7.3% of GDP in 2014. Government expenditure increased by nearly 25% to target "development enablers" as identified in the 2013 - 2017 Medium-Term Development Plan. The budget also slowed spending, with an increasing share of it carried out at sub-national levels (provinces, districts and local governments). The taxation system is currently undergoing a major review by Sir Nagora Bogan who will present a full report in 2015.

In summary, while LNG exports are set to transform the country's balance sheet, they are also expected to widen the wealth gap. This will have long-term negative consequences.

12 | Sustainability

Although there are strict laws on environmental protection, environmentally compatible growth receives almost no consideration. Many in the government believe that rapid growth requires compromises in environmental protection and quality. There is a Department of Environment (DOE), but its work is often compromised by more powerful ministries, such as trade and industry. For years, NGOs have documented the failure of the forestry authority to apply its own logging regulations in PNG. The government's Office of Climate Change and Environmental Sustainability (OCCES) within the Department of Environment and Conservation was paralyzed when its director was caught trying to sell nonexistent carbon credit on the international markets. Environmental protection is also compromised by greed and corruption, which frequently leads to the violation of existing regulations. An example of this is the \$1.5-billion Ramu nickel/cobalt project, which daily dumps 14,000 tons of toxic waste into the Bismarck Sea. It was shut down in April 2012 by the Minister of Environment and Conservation but in December 2012, Prime Minister Peter O'Neill officially re-opened the plant.

In February 2014, parliament established a new Conservation and Environment Protection Authority (CEPA). CEPA will replace the Department of Environment and Conservation as the government agency responsible for administering the Environment Act 2000. CEPA provides for payment of a new "environment

Environmental
policy

4

management fee.” Another significant development in the period under review is a report by NGOs showing Australian banks in PNG were providing financial services and loans to logging companies involved in illegal logging and land grabs. A government task force separately identified millions of dollars of illicitly gained funds from corrupt PNG companies being laundered through Australian banks.

There are four state universities and several private tertiary institutions, but they all underperform academically. Many of the state universities are persistently underfunded, and academic staff regularly strike over unpaid salaries and poor working conditions. Discipline among students is also a worry.

During the period under review, there were major student disruptions at three institutions, the University of Papua New Guinea (UPNG), the University of Technology (Unitech) and the University of Goroka. There were also tribal fights and shootings on campus during the period under review. The vice chancellor of Unitech, a foreign national, who was expelled from the country after a dispute with the University Council in 2013, returned a year later. The financial situation at the UPNG has improved under a new vice chancellor. He managed to halve its debts within 12 months of taking office. Nevertheless, the entire university sector is chronically underfunded on top of poor staff resources and poor teaching. The government allocates less than 2% of GDP to education. In many cases, the allocated sum is not paid out in full as the money is diverted to more pressing political issues. There is almost no state investment in R&D.

A high-profile report involving former PNG Prime Minister Sir Rabbie Namaliu and Professor Ross Garnaut of the Australian National University was published in 2010. The report recommended significant increases in funding and staff numbers at PNG universities. The report’s recommendations have not been implemented and are not likely to be implemented in the foreseeable future.

Education policy /
R&D
3

Transformation Management

I. Level of Difficulty

The structural constraints on governance are massive and cannot be overcome for at least a decade or more. There are low levels of trust between government agencies, frequent changes among ministers, and the government bureaucracy itself is heavily politicized, inefficient and corrupt. Other constraints that have taken their toll on the country include: low education levels, a lack of basic infrastructure, a small and underperforming economy, aid dependency and ethnic conflicts. PNG is experiencing rapid, sustained population growth of about 2.7% annually, and it has the highest rate of reported AIDS/HIV cases in the region. Approximately 0.92% of the adult population in Papua New Guinea was living with HIV in 2009 (latest figure). This figure is likely to be higher now. While many consider PNG to be a weak state, it is important to bear in mind that the modern state system has been superimposed on thousands of tribal groups across not only vast regions of rugged terrain, but hundreds of islands as well, with dramatic logistical difficulties for government and governance. In the period under review, nothing much suggests the constraints will change.

Structural
constraints

8

If anything, political governance has gotten worse under Prime Minister O'Neill. He has regularly bypassed parliament and his own cabinet, and tried to control the judiciary by passing a law, since rescinded, that weakens tenure for senior judges. He also disbanded an anti-corruption task force when it charged him with corruption. In 2014, he unilaterally approved a three-billion kina loan from Union Bank of Switzerland (UBS) despite opposition from the treasurer (finance minister). The treasurer was sacked shortly afterwards.

In a traditional society like PNG, it is a challenge to build social cohesion amidst social dilemmas. In general, civil society traditions are weak and mostly concentrated in urban areas where most of the educated population lives. The challenge for NGOs and CSOs can be viewed against what the churches have achieved, particularly since the 1950s. While churches instilled alternate faith systems, and have sustained international financial backing, most NGOs/CSOs face the following challenges: (a) they compete with whatever traditions society instills in people, and (b) many NGOs/CSOs do not enjoy sufficient funding over time.

Civil society
traditions

6

Furthermore, NGOs/CSOs are viewed with caution given that their activities quite often are viewed as anti-development, anti-progress, anti-government etc. Unless the people in question have issues with the government or elected national leaders in that specific locality, it is difficult to see ordinary people being inspired by a general issue just because an NGO/CSO is promoting it.

PNG society and its political elite are deeply split along the lines of social class, and tribal and regional groups. Rent-seeking behavior inside the public bureaucracy is rampant. The formation of the PNG government by Peter O’Neill after the elections saw an open display of these divisions when the “highlands bloc” repeatedly demanded senior cabinet posts because O’Neill comes from the Southern Highlands. This regional and ethnic “balance” has been in place since independence.

The previous Somare administration was repeatedly accused of favoring Sepiks (Somare is a Sepik) when appointing senior public servants while O’Neill is often accused of marginalizing Sepiks. There is some tension among Christians and Muslims in PNG when it was revealed in 2012 that there were more than 5,000 converts to Islam in the country.

Conflict intensity
7

II. Management Performance

14 | Steering Capability

The political leadership tries to pursue long-term aims, but often postpones them in favor of short-term political benefits. Although the government regularly commits itself to five-year development plans, it does not have the capacity to carry them through. Weak institutional efficacy, a poorly functioning bureaucracy and the lamentable state of political parties exacerbate problems with coherent planning and policy prioritization. With the turnover rate of members of parliament at more than 50% over the last four elections, it is clear to see why priorities are often planned for five years (i.e., the electoral cycle), so that members of parliament can do what they can to stand a better chance of re-election.

In the period under review, the O’Neill government can claim one major economic success: the completion of the LNG project. This massive, \$19 billion project could have easily been derailed, but managed to be completed with only a slight delay. The first shipment has gone to Japan, and the PNG economy is expected to grow by a massive 21% in 2015 when the LNG plant is fully operational. Other than the LNG project, there is no major success. In fact, PNG did not meet any of the Millennium Development Goals for poverty, health and education.

Question
Score

Prioritization
5

The government regularly fails to implement most of its stated reform goals. The biggest problem for elected representatives is that they are chosen for each five-year parliamentary term by voters who expect them to deliver basic services directly to them. Given that the state system, through the public service, has been increasingly weakened for a plethora of reasons over time, the parliamentarians see it in their ambit to deliver services directly to the people. This forges a strong reciprocal relationship between members of parliament and voters in all regions of the country.

Implementation
5

Many of the latest laws and policies have been skewed towards service delivery by members of parliament. Another major problem for the implementation of reforms is that senior politicians interfere regularly in civil service operations. Senior public servants often give conflicting orders to those given by regional governors. Most reforms are initiated by the prime minister's office but are often not implemented due to an inefficient civil service that is particularly weak outside major urban areas. A survey undertaken a few years ago revealed that more than two-thirds of cabinet decisions were either not carried out or were not carried out in full by the civil service.

Reforms undertaken to make the civil service more effective have also failed in recent years. Despite various attempts at strengthening capacity such as the "Strongim Gavman" Program (SGP), which is Tok Pisin for "strengthening" or "empowering" government, and which involved using nearly 40 Australian officials as key advisors in the PNG bureaucracy, nothing has worked.

When O'Neill formed the government, he announced that tackling corruption was his key priority. In August 2011, the O'Neill government created an "Investigation Task Force Sweep" (ITFS). Its mandate was to investigate allegations of corruption and mismanagement in government. In May 2012, the ITFS final report stated that the level of corruption in Papua New Guinea had "migrated from a sporadic to a systematic and now an institutionalized form of corruption." When the task force charged the prime minister with corruption in 2014, he swiftly shut the ITFS down and its head, Sam Koim, was forced to flee to Australia. The prime minister also sacked the attorney general and deputy police commissioner.

Although policies are reviewed on a regular basis and reports undertaken, there is no real change or learning from past mistakes. Three major multilateral organizations, the World Bank, Asian Development Bank and International Monetary Fund (IMF), review PNG's progress on an annual basis and offer policy suggestions. The political leadership will respond with proposed changes to failed policies, but, more often than not, policies remain stuck in the same routines. There is no political will to correct past mistakes as the core issue is usually corruption and fraud. The leadership is also more prone to adopt policies that offer little or no threat to them in their present positions.

Policy learning
4

15 | Resource Efficiency

The central government rarely uses resources efficiently. Political expediency and interference means that public resources are regularly wasted. In the provinces, the situation is even worse as many provincial governors treat the state (through their standing/authority in their respective provinces) as their personal fiefdom. Provincial governments, and to a lesser extent, the central government, are plagued by the mismanagement of funds, the dismissal of senior staff and “nepotistic” or wantok-based appointments. The problem is compounded by a lack of centralized monitoring for the provinces. In the highlands, for example, governors have an almost free hand to do what they want. What they want to do is to reward their political supporters and to use state assets to get re-elected. Thus, the entire government machinery is used to mobilize political support rather than develop the province. Yet this does not stop the ministers themselves from criticizing waste. At the 2014 National Leaders’ Summit, Prime Minister O’Neill said the history of government-owned businesses was “absolutely appalling. The amount of scarce public money - taxpayers’ money - that has been wasted, stolen and misused by state-owned corporations over the almost 40 years since independence runs into billions of kina.” Another problem is that government services at the central level are duplicated at the provincial level.

Efficient use of assets

4

One important problem with the PNG budgetary process is the lack of monitoring. In many ministries and provincial governments, off-budget items are paid through “special purpose accounts” (SPA). In some instances, these accounts contain millions of kina for discretionary spending by the minister and are not subject to audit. The government is also prone to overspend during elections in order to buy support, and money was given out directly to members of parliament for the 2012 national elections.

In 2014, the government budget was PGK 15 billion (approx. \$5.5 billion). The 2013 budget deficit of 7.9% has been reduced to 5.9% in the 2014 budget. The budget is expected to return to surplus in 2018. The budget’s debt-to-GDP ratio was 35% in 2014. No new taxes were introduced.

The big issue in the period under review, with the first shipment of LNG to Japan in 2014, is the massive revenue to be generated by LNG exports for the next 30 years. The PNG government announced that it will establish a sovereign wealth fund (SWF), but disagreements over its structure and control caused it to be delayed. In the period under review, the government tried to assume direct control over PNG’s Sustainable Development Programme (PNGSDP) Ltd., a mini version of SWF. The PNGSDP was established under the regime of Sir Mekere Morauta, who is also the chair of PNGSDP, to take ownership of the Ok Tedi mine from BHP Billiton when the latter pulled out of PNG. The fund controls about \$1.4 billion in trust, and uses the interest to fund development projects in Western Province, where the mine is

located. To ensure minimum political interference, Morauta registered PNGSDP as a company in Singapore. In 2013, the O’Neill government decided that PNGSDP ultimately belongs to the state and took control of a 63% share. PNGSDP (the Singapore representation of the PNGSDP) sued the PNG government in the Singapore Supreme Court. When it won an injunction against the PNG government’s move to take control of its shares, the PNG government passed an amendment to the Ok Tedi law to take control of all the shares and proceeds from Ok Tedi, effectively taking over PNGSDP. It then transferred some of these shares to the Western Province provincial government. It also tried to appoint Arthur Somare, a former member of parliament and son of former Prime Minister Sir Michael Somare to the board of PNGSDP.

The central government tries to coordinate policy-making through the Central Agencies Coordination Committee (CACC). However, ministers and senior politicians often interfere with the process by giving conflicting instructions. A key problem is the faulty Organic Law on Provincial Governments and Local-level Governments. The frontline offices of agencies and national departments are not aligned throughout the three levels of government, making coordination difficult and cumbersome even in a centralized system of government. A weak, inefficient and corrupt civil service adds to the difficulty of policy coordination. The low quality of data available for policy-making is a related problem. The Department of National Planning and Monitoring (DNPM) often relies on statistics that are suspected to be flawed, incomplete and inaccurate.

Policy
coordination
3

Corruption is systemic and systematic. The previous prime minister, Michael Somare, has been accused of owning several properties with corrupt money in Queensland, Australia, while the current prime minister, Peter O’Neill, is described in a WikiLeaks cable as “quite corrupt. He’ll be interested in just one thing – money.” The Ombudsman Commission conducts investigations of political leaders suspected of corruption, but once a politician resigns, the commission can no longer legally investigate the case. At present, it is seriously understaffed and has been underfunded for many years. While the commission keeps its door open to assist members of parliament in any way, there is a history of mistrust between these two sides that goes back three decades. It is believed that the commission is purposely underfunded to weaken and curtail its work.

Anti-corruption
policy
3

The Department of National Planning and Monitoring (DNPM) is the main agency auditing government spending. Yet an audit of the DNPM in 2012 revealed “grand corruption” within the very department charged with monitoring government spending. In 2014, the minister in charge of DNPM was sentenced to nine years in jail for corruption and fraud. The prime minister disbanded an anti-corruption task force he established two years earlier when it accused him of corruption.

16 | Consensus-Building

All major political actors agree on the goals of building a market-based economy and liberal democracy. This consensus is shared by the population as well. Many feel that a market-based economy is the only viable option for the country's future. However, given the deficits observed in managing the democratic process and the transformation to a market economy, this consensus remains unattainable until the issue of high-level corruption is dealt with. This pattern is consistent with many countries in Melanesia. Neighboring countries such as the Solomon Islands suffer from the same problem. The key issues always come back to high-level corruption.

Consensus on goals
8

There is widespread agreement that a market economy is the only viable option for PNG. Although some intellectuals talk about a "Melanesia economy" or "village economy," they cannot offer a concrete way to implement policy. In any case, they cannot even agree on the definition.

Reformers cannot prevent all of the powerful anti-democratic actors, such as tribal groups and regional political leaders, from seeking control of the state, but they can at least limit these groups from exercising their power. The basic cleavage between the highlanders and people living in the lowlands or coastal areas has dominated political conflicts since independence. Their mutual attempts to dominate the political process have not resulted in either side successfully controlling the state for any long period. General elections are held every five years ensuring a turnover of political leaders. The constant change in government and repeated shifts in cabinet members ensure that anti-democratic forces are held in check. It should be noted here that anti-democratic actors in PNG are mostly rent-seekers and opportunists rather than those who wish to replace liberal democracy with an authoritarian system. Furthermore, the coast-highlands divide was much more pronounced in the past. The danger for the country is not a rejection of democracy or authoritarian rule, but kleptocracy.

Anti-democratic
actors
6

The political leadership does not seek to reduce existing divisions or prevent conflicts from escalating. Clan, tribal and regional loyalties form the basis of their political support. Moreover, there is a low level of trust between groups; hence tribal divisions are a permanent feature of society. Tribal wars and other acts of violence, especially in the highlands, occur on a regular basis. In some cases, political leaders encourage the cleavages in order to secure political power. For example, it is common for politicians to form regional "blocs," such as the island bloc, highlands bloc, etc., to negotiate cabinet positions and other government resources after every election.

Cleavage /
conflict
management
5

The allocation of ministries to regions has been a practice since the pre-independence years. It has been common for members of parliament to allude to regional groupings in recent times only when there were reshuffles in cabinet and some members reacted

negatively to them, or when there was a need for more say by one region (over others) in line with the significance of activities in one region.

Although this political “balancing” may seem out of place in modern politics, many developed countries practiced a similar system. In Belgium, for example, the top political offices are divided up between the Flemish, German and French-speaking regions.

The political leadership frequently ignores civil society organizations (CSOs), seeing them as political rivals and anti-growth elements. More often than not, the government formulates its policy autonomously and secretly, especially when it comes to controversial policies. Examples of the government ignoring CSOs include its policies relating to logging and deforestation, and those relating to environmental protection and pollution control. The fact that many CSO leaders regularly run in elections compounds the problem, as it nurtures the widely held view that CSOs are just political parties in all but name. Some example of CSO candidates in the 2012 general elections: Kenn Mondiai (former chairman of NGO PNG Ecoforestry Forum) and Dorothy Tekwie (from the environment movement) and Janet Sape (Wimen in Bisnis Faundesen – Women In Business Foundation).

Civil society
participation
4

The political leadership recognizes the need to deal with historical acts of injustice, but the process of reconciliation often fails. Land compensation claims constitute a prime example of a historical act of injustice. During the colonial administration, all land not issued with a title became state land. After independence, land with titles constituted less than 7% of all available land in PNG. This has led to numerous conflicts and tribal wars in which people have died fighting over land rights and compensation claims from the government. Because land ownership is such a sensitive issue, no government since independence has made any serious attempt to survey the land and issue titles. The only success observed in addressing a historical act of injustice in PNG is the reconciliation process that has taken place between the central government and the people of Bougainville. After more than a decade of civil war, the central government permitted an autonomous Bougainville government (ABG) to be established on the island in an attempt at reconciliation. However, the process is under strain as both sides distrust each other. The ABG and other political factions have made it clear to the government that they want a referendum on independence, and they are actively working toward a referendum sometime in the next decade. In 2014, Peter O’Neill became the first sitting prime minister to visit Bougainville since 1977.

Reconciliation
7

17 | International Cooperation

Since independence, PNG has cooperated with and received extensive help from several international bodies to help with its development goals. The PNG government's development agenda, according to official documents, is devoted "to growing the country's future by making key investments focused on inclusive and sustainable growth for all" and to becoming a fully developed country by 2050 ("Vision 2050"). Among the major players helping PNG develop are the UNDP, ADB, IMF, World Bank and AusAid. PNG receives one of the highest per capita levels of aid money in the world. PNG is also an active member of the South Pacific Forum and plays a leading role in the African, Caribbean and Pacific states (ACP countries) pact with the European Union. However, PNG's record of putting aid to effective use is mixed at best. Many aid programs have failed, and corruption has also had a severe effect. The Review of the PNG-Australia Development Cooperation Treaty, a 2010 report commissioned by the PNG and Australian government, stated that "there is widespread dissatisfaction with the aid program in both Papua New Guinea and in Australia [...] There is a perceived lack of impact, and failure to obtain value-for-money [...] they also reflect a growing body of evidence which strongly suggests that substantial change is needed." There are many cases in which foreign aid money has gone unused because the bureaucracy has been unable to comply with the paperwork. Four years after the report, not much has changed. In her keynote speech to the 2014 Australasian Aid and International Development Policy workshop, Australian Foreign Minister Julie Bishop said, "I find it distressing to know that despite the fact that Australia invests about half a billion dollars each and every year into Papua New Guinea, it will not meet one of its millennium development goals. In fact, it is going backwards. It is not on track to meet one of the seven millennium development goals."

Effective use of support

6

PNG's international reputation is mixed in the international arena. Many countries see PNG as a weak state and therefore they do not have high expectations. On the one hand, they recognize that PNG is the most important country in the Melanesia Spearhead Group countries and the biggest economy in Melanesia. PNG troops have also served as peacekeeping troops. On the other hand, they know that successive governments in Port Moresby have had limited capacity or political will to reform. This is very obvious in border control. It is common knowledge that PNG cannot control or watch its borders with both Indonesia and Australia. The Australian Government has publicly identified the Australia/PNG border as a major transit point for gun and drug smuggling and, recently, as a potential entry point for illegal immigrants. The PNG/Indonesia border is also rife with the smuggling of weapons and consumer goods. In October 2014, Australian police seized nearly 1000 cannabis

Credibility

5

plants and enough chemicals to create \$2.5 million worth of methamphetamines, all coming from PNG.

Many governments hold the view that PNG cannot be a reliable partner in promoting democracy and the market until it resolves its governance and corruption issues. Foreign investors generally see PNG as a high-risk environment for investment, although it is understood that returns are high for the same reason.

The government actively cooperates with neighboring states and complies with the rules set by regional and international organizations as best it can. It takes part in all major international meetings. It is the unofficial leader of the Melanesian group of countries (Fiji, PNG, Solomon Islands, Vanuatu, New Caledonia) and it plays an active role in the South Pacific Forum (SPF). It is a member of all the international organizations.

In the period under review, the most significant regional act by the O'Neill government was to accept the reopening of a refugee camp on Manus Island for illegal immigrants heading for Australia. Under the deal, Australia will pour millions into the Manus and PNG economy. In 2013, another agreement with Australia allows genuine refugees heading for Australia to be resettled in Papua New Guinea. The O'Neill government has signaled that it intends to play a leading role in the SPF in coming years, a role usually associated with Fiji.

Regional
cooperation
8

Strategic Outlook

During the past two years, Papua New Guinea made some progress on the economic front, but this was due more to the construction of the LNG project (which was completed in 2014), mining receipts and high oil and commodity prices than to internal factors. GDP grew by 6.0% in 2014 and is set to soar to a record 21.0% in 2015, driven by exports of liquefied natural gas (LNG). 2015 will be the first full year of LNG production. Growth outside of the oil/gas sectors slowed to less than 2% in 2014. Any achieved outside the oil/gas sector in recent years - largely spillover from LNG pipeline construction - has dissipated. With construction of the pipeline completed, the construction sector contracted by 6.4% in 2014, while activity in transport and logistics, wholesale and retail trade, and financial services appears likely to slide from the highs recorded over the past three years.

In the short term, the biggest challenges facing the country are the need to stabilize its politics, confront high-level corruption, further liberalize the economy, and maintain consistent growth. The key to PNG's long-term economic prosperity remains the LNG project. The money generated by the project should be spent on productive sectors such as infrastructure (rather than spending on consumables) and some of it should be kept in a sovereign wealth fund for future generations. The establishment of SWF should be done in a transparent manner. The government should concentrate on ensuring private-sector expansion and on reforming the bureaucracy to make it more efficient and private-sector friendly. The government must improve the quality of public expenditure so that public funds spent through the national budget create tangible development, especially in the area of infrastructure. The government must also take some concerted action to combat high-level corruption and to secure its monopoly on the use of force throughout the country.

In the short term, there is real opportunity for real reform as the O'Neill government dominates parliament (there are only three opposition members left). What is needed is political will. Policies and decisions taken in the short term will have long-term benefits. Gains associated with the LNG plant, scheduled to operate for 30 years, rely on a resource that cannot be replaced.