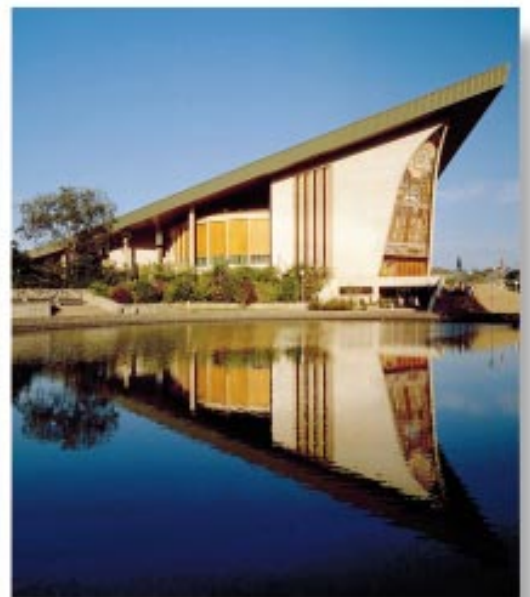


Papua New Guinea



ECONOMIC REPORT • FEBRUARY 2001





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- Pacific Century Bank, N.A. (9 branches)

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TO OUR CLIENTS AND FRIENDS:

We are pleased to present our second economic report on Papua New Guinea (PNG). It contains an assessment of the financial and economic conditions of PNG in the recent past and offers a perspective on where this country, rich in natural and mineral resources, is headed.

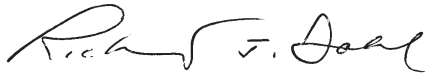
The PNG economy is in a critical economic and financial transition as it moves from a period of relative economic, financial and political instability to a time of economic growth and stability in the next few years. Now that the Asian financial crisis and recent drought are over, and the International Monetary Fund (IMF), the World Bank and Australia are providing PNG with financial and economic assistance, the prospect for economic growth has improved considerably.

The economy returned to growth in 1999, following a recession in 1997-98, continued to expand in 2000, and is expected to grow in 2001-2002. As PNG's financial and economic performance stabilizes in the next few years, the country's capacity to attract foreign capital, which is critical for some of its large mining projects, will improve. As more of these projects are funded, needed jobs and tax revenues will be created.

Bank of Hawaii entered the Papua New Guinea market in 1997, and we look forward to participating in PNG's economic and financial growth.

This report on the economy of PNG is part of our commitment to our customers in the Pacific island markets we serve. We invite you to visit the Economics section of Bank of Hawaii's Internet web site, www.boh.com, for reports and updates on other Pacific Island economies, as well as information on the range of financial products and services we offer.

Aloha,



Richard J. Dahl
President and
Chief Operating Officer



Richard J. Dahl

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All photos:

Rocky Roe, Rocky Roe Photographics, Papua New Guinea

PAPUA NEW GUINEA (PNG)*Land Area*

Total: 462,480 square kilometers (178,704 square miles)

Largest Island: New Guinea

Total Islands, islets and atolls: over 600

Largest City: Port Moresby (population 200,000)

Political Status

Independent nation

20 provinces (including national capital)

European-style parliamentary democracy

General elections held every five years

Seats in parliament: 109

Next Election: June 2002

Population

1990: 3.7 million

2000: 4.8 million

1990-2000 Growth rate: 2.6 percent

Economy

Currency: Kina

Major income sources: subsistence, commercial agriculture and fishing, forest products, mining (copper, gold, silver) and petroleum

Gross Domestic Product (GDP) in 2000: \$3.7544 billion

Per capita GDP in 2000: \$782

Exchange rate (2000): \$0.3386/Kina

GDP Makeup by Sector (2000)

Agriculture, fishing and forestry: 25.1 percent

Mining & quarrying: 17.1 percent

Community & social services: 10.6 percent

Petroleum: 9.1 percent

Manufacturing: 9.1 percent

Commerce (trade): 8.6 percent

Construction: 7.1 percent

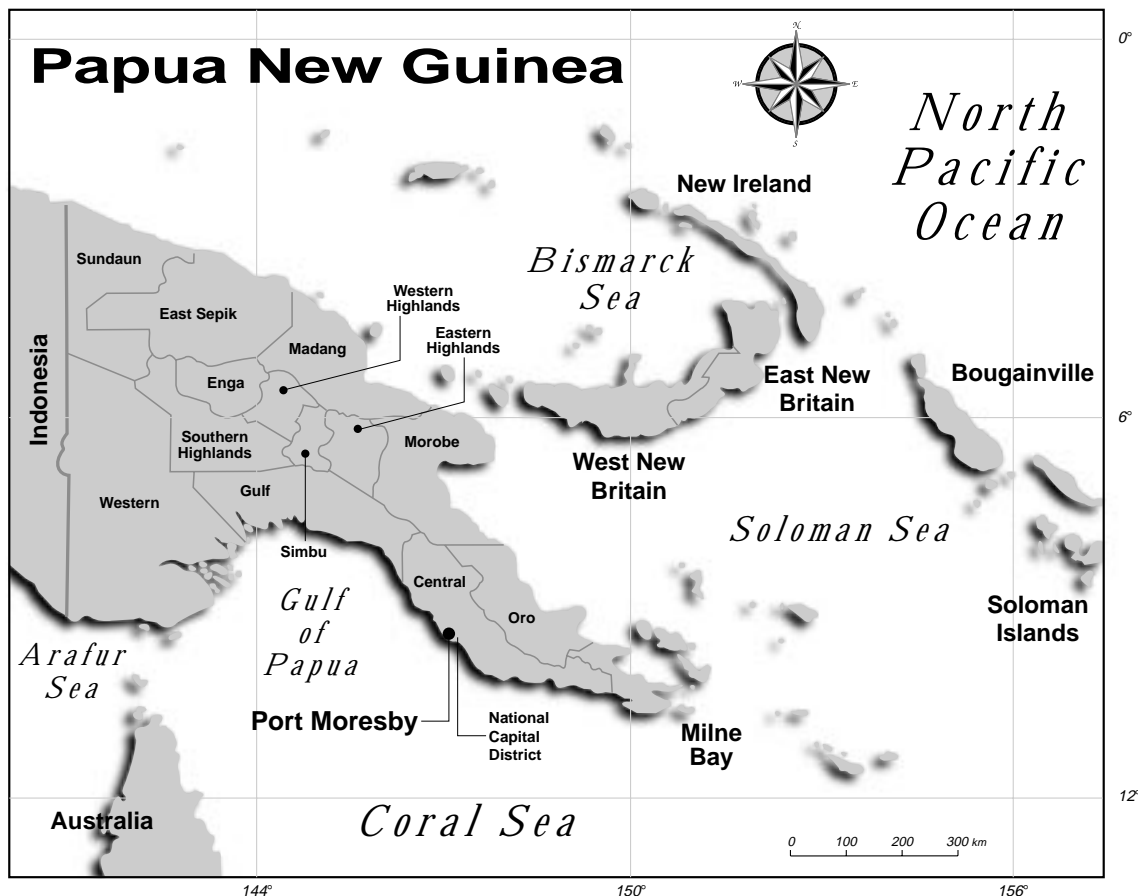
Transport & storage: 5.4 percent

Distance From

Honolulu: 4,100 miles

Sydney: 1,745 miles

Brisbane: 1,300 miles



I. GENERAL CHARACTERISTICS

I.1 Introduction

Papua New Guinea (PNG) is one of the South Pacific's largest island countries, comprised of some 600 islands, atolls and coral reefs. With a land area of 462,840 square kilometers (178,704 square miles), PNG is about 15 percent larger than California, almost 28 times the land area of Hawaii and nearly twice the landmass of the United Kingdom.

The Island of New Guinea is the world's second largest island after Greenland. Its eastern half accounts for more than 80 percent of PNG's total land area. (Its western half, as Irian Jaya, has been part of Indonesia since 1963.) PNG's smaller islands include the Bismarck Archipelago, mainly New Britain, New Ireland and Manus, and the northern end of the Solomon Islands chain, Bougainville and Buka.

PNG's climate is consistently hot and humid throughout the year, with average temperatures ranging from 22 degrees C (72 degrees F) to 33 degrees C (91 degrees F).

PNG's tourism slogan "the land of the unexpected" reflects its unique geography and topographical makeup. The main landmass is dominated by rugged mountains with vertical cliffs, deep and lush valleys, enormous river systems, dense forests, spectacularly lush coastal regions and large coastal swamps.

The country is vast, especially by Pacific island standards. Yet it lacks a national road network that would link commercial and urban centers to agricultural production and distribution centers. This makes production and distribution difficult and inefficient. Anecdotal evidence suggests, for example, that small coffee growers in some of the highlands cannot ship their harvests to commercial centers because of lack of economical transport. Nor can they grow coffee in quantities large enough to attract large-scale commercial transporters. The result is that among small farmers some coffee ends up as waste, even as PNG relies on primary commodity exports for a large share of its foreign exchange.

Official estimates put rural population at 80-85 percent of the total, but the actual share may be as high as 90 percent. The main support system of rural communities is subsistence production and the traditional village structure. With the money economy reaching more rural areas, some subsistence produce is now sold for cash in open markets.

Electricity, telephone and commercial water and sewer systems are unavailable in many rural areas. The urban centers of Port Moresby, the capital, Lae, the second largest city, and Kimbe, Rabaul, Kavieng, Buka and Arawa are far from each other. They are accessible by regular commercial air transport only, while commercial shipping service connects the various commercial ports around the country.

The urban economy in PNG is developed and modern, but it is too small in the national macroeconomic and demographic context. The economy is also highly dualistic, with rural and urban segments poorly connected, both physically and financially. However, since most of the financial support PNG receives either through foreign aid

or private investments flows to the rural economy via the national capital, the central government is in a position to play a critical role in linking urban and rural economies. A first step would be to build a national road network.

Apart from the size of PNG's landmass and the challenges it presents to logistics and transport planners, linguistic and cultural diversities set PNG apart from all other Pacific Island societies. PNG has 867 living languages, one-third of the world's languages in use.¹ Some are spoken by fewer than 10,000 people.² Melanesian Pidgin and Hiri Motu are the most widely spoken, especially in urban areas. English, on the other hand, is the language of business and government.

Literacy rate estimates vary, but more than half of PNG's population is believed to be functionally illiterate, and only a fraction of the literate population has primary or high school education. To the degree that high functional literacy rates, education and strong democratic traditions make a democracy more representative, if not more efficient, PNG's democracy is hampered by a lack of educated voters and durable institutional checks and balances. Still, PNG's version of democracy has survived for 25 years following independence. In a society of such enormous linguistic and cultural fragmentation, only a functioning democracy can make possible a continuing open dialogue on national and regional priorities.

At the same time the diversity of interests inherent in numerous ethnic and linguistic groups, especially in a developing economy where political and market institutions are evolving, has made it difficult to establish a strong and decisive central government. Political coalitions are sometimes formed based on allegiances of convenience rather than ideology and policy. Given the history of parliamentary democracies elsewhere, we can say that PNG's has worked fairly smoothly. But as is evident elsewhere also, better education and more mature political and economic institutions are the conditions for a strong democracy, which, in turn, helps sustain a dynamic market system.

Australian influence is dominant in PNG because the two countries have had close political and economic ties for several decades. Apart from being a close neighbor, Australia also is PNG's biggest trading partner, provider of the bulk of its foreign aid and the source of much of its physical and human capital. Australian investment in PNG is easily about \$A 5 billion, and Australian expatriates living in PNG number 25,000-35,000.

The number of skilled PNG citizens, though growing, is small. It has not kept pace with the demand for skilled labor, which is rising rapidly. For this and other reasons, PNG is often listed last among the Pacific Island economies as measured by health, quality of life and economic and financial indicators. PNG's life expectancy at birth is 57 years, one of

¹Sean Dorney, *The Sandline Affair: Politics and Mercenaries and the Bougainville Crisis* (Sydney: ABC Books), 1998, p. 18.

²The Australian Agency for International Development (AusAid), *The Economy of Papua New Guinea: 1999 Report*, p. 2.

the lowest life expectancies in the South Pacific.

In 2000, PNG's population was an estimated 4.8 million, mainly Melanesian. In 1990-2000, population grew from 3.7 million to 4.8 million, for an annual growth rate of 2.6 percent. This growth rate is near the norm for the Pacific's developing economies. The high end of population growth in the region, 3-4 percent annual gain, is still common in only a few Pacific economies such as PNG's nearby neighbor, the Solomon Islands.

Keeping in mind that population projections have not proved accurate in the past, suppose that PNG's population growth remains at 2.6 percent a year. Maintaining the current standard of living as measured by per capita income of less than \$800 a year in 2000 would require higher real per capita gross domestic product (GDP) growth than the 2.1 percent rate of 1990-2000. A rough rule for maintaining living standards is that real (adjusted for inflation) per capita income growth equal population growth.

In fact, PNG has the resources to not only maintain but elevate its current standard of living. What is needed is an aggressive agenda for economic development supported by the necessary institutional changes that would attract more capital and skills to the country.

In US dollars, PNG generated a total GDP of \$3.8 billion in 2000, yielding a per capita GDP of \$782. (PNG is in the same World Bank per capita GDP category as Bolivia, Indonesia and the Philippines.) Again in US dollars, PNG's GDP fell from \$5.4 billion in 1994 to \$3.8 billion in 2000. Most of the decline resulted from the Kina, PNG's currency, depreciating against the US dollar in that period.

In 1994-2000, the Kina depreciated against the US dollar 66.0 percent, 51.5 percent in 1997-2000 alone. Had the Kina remained at the 1994 exchange rate against the US dollar, PNG's nominal GDP in US dollars in 2000 would be almost the same as the amount in Kina, for a per capita GDP of nearly US\$2,300. Foreign exchange rates, especially when not adjusted for price parity and changes in purchasing power based on domestic price changes, distort nominal income comparisons in foreign currencies. It is best to focus first on PNG's economic data in Kina, using PNG's price inflation to adjust for price increases.

I.2 A Brief History

Evidence suggests that PNG is among the oldest societies in the world. Human occupation evidently began some 45,000 years ago on the Huon Peninsula on the north coast of the main island. The first settlers are believed to have arrived from Southeast Asia in small numbers.³

By the time of European contact in the early 16th century, important food plants included sago and coconut palm, taro, yams, cassava, sweet potato, breadfruit, and bananas. PNG's fauna at the time included wallabies, snakes and crocodiles, and chickens, pigs and dogs, the

LAND AND POPULATION

Province	Area (sq. kms.)	Population 1990	Population 1999	Density Per sq. km
Southern Region	200,340	771,193	1,000,806	5
Western	99,300	110,420	150,682	2
Gulf	34,500	68,737	73,232	2
Central	29,500	141,195	167,582	6
National Capital	240	195,570	298,145	1,242
Mine Bay	14,000	158,780	193,367	14
Northern (Oro)	22,800	96,491	117,798	5
Highlands Region	62,400	1,373,673	1,667,959	27
Southern Highlands	23,800	317,437	413,006	17
Enga	12,800	235,561	324,118	25
Western Highlands	8,500	336,178	417,507	49
Simbu	6,100	183,849	189,069	31
Eastern Highlands	11,200	300,648	324,259	29
Northern Region	142,600	1,027,600	1,211,635	8
Morobe	34,500	380,117	456,700	13
Madang	29,000	253,195	298,896	10
East Sepik	42,800	254,371	288,080	7
West Sepik (Sandaun)	36,300	139,917	167,959	5
Islands Region	57,500	589,488	769,117	13
Manus	2,100	32,840	40,583	19
New Ireland	9,600	86,999	111,906	12
East New Britain	15,500	185,459	251,032	16
West New Britain	21,000	130,190	184,275	9
Northern Solomons (2)	9,300	154,000	181,321	19
Total	462,840	3,761,954	4,649,517	10

Source: Department of Trade and Industry, *Statistical Digest 1998-99*, p. 17.

latter having been introduced to the islands from elsewhere.

There is not much solid evidence of contact between Papua New Guinea peoples and the rest of the region before the 19th century. However, there is reasonable likelihood that trade between Indonesia and the western half of the Island of New Guinea extended as far back as the 13th century, and there is some evidence of much older trading region-wide. There is also the likelihood that before the arrival of the Europeans some coastal people from today's PNG were captured by Asian raiding parties for sale as slaves. However, no new settlements were established, and the contacts between New Guinea and Southeast Asia appear to have ended when Europeans arrived.

Evidence also suggests that at the time of the first European contact, many different communities lived in isolation from each other, separate societies speaking mutually unintelligible languages but linked to a degree by trade networks. Thus the challenges of communication and structural fragmentation that face PNG today can be traced back to earlier periods.

Europeans navigators first visited PNG in the early 16th century, but colonial settlement did not occur until the mid-19th century. In 1884, the northern part of eastern New Guinea came under German rule and later became German New Guinea. In 1914, Australian troops removed

³John Dademo Waiko, *A Short History of Papua New Guinea*, Oxford University Press, 1993, p. 2

the Germans from the territory and Australia subsequently controlled the area under a League of Nations mandate until 1942, when it fell to Japan. In 1945, the territory returned to Australian rule under a UN trusteeship.

The House of Assembly, renamed the National Parliament when PNG became independent, was first formed in 1972. The Territory of Papua New Guinea became internally self-governing in December 1973 and totally independent on September 16, 1975. Following the Australian model, PNG is a parliamentary democracy, with 109 seats. Administratively, PNG is divided into 19 provinces and the national capital district (NCD) as the 20th province. National elections are held every five years.

I.3 Bougainville: From Secession to Settlement

Political uncertainty of some sort arising from ethnic, linguistic, cultural and power and wealth sharing differences existed long before independence in 1975. On independence, PNG inherited from Australia a centralized and highly bureaucratic government in Port Moresby. In some instances, citizens and provincial governments, some hundreds of miles away from each other and the main landmass, felt they were not receiving their fair share of income and wealth from the central government or from foreign operators. This sense of inequity led to the rebellion in Bougainville, starting in 1988.

In April 1988, landowners on Bougainville submitted claims for more than was being paid by the Bougainville Copper Limited at Panguna, which had been mining since 1972. With no additional payments in sight, a group proclaiming itself the Bougainville Revolutionary Army (BRA) engaged in acts of sabotage in 1988, sparking the beginning of the rebellion.

The rebels demanded both higher payments and independence for the North Solomons Province, of which the Island of Bougainville is the major part. With violence escalating, mining activity stopped in 1989-90. In the 1990s, the Bougainville conflict was among the few globally known continuing wars, paralyzing Bougainville's economy and destroying most of the island's infrastructure including schools and hospitals.

The BRA kept the conflict current in regional and global news for a decade. With the violence escalating but no victory in sight for either side, the rebels and Port Moresby opted for talks sponsored by New Zealand in 1997. The 500 miles of ocean between Port Moresby and Bougainville have made both war and peace more difficult. And while hostilities have ended, the talks leading to reconciliation do not guarantee that other parts of PNG will not rise against Port Moresby, especially if there is a recurrence of the perception that the provinces are not receiving their fair share of national income, wealth and political and economic autonomy.

It was not until the Bougainville war that PNG's integrity as a country came into question. However, to Port Moresby's credit, the uprising did not spread to other parts of the country as might have been expected, given the

country's ethnic diversity and dispersed island landscape.

While the secession war has ended, the peace process has been bogged down in protracted negotiations for nearly three years. Nor is there any assurance that the cease-fire will last indefinitely since the weapons obtained during the 10-year secession war remain in the hands of the rebels. One rebel leader still calls unequivocally for independence for the Bougainville Province. Port Moresby expects that an inclusive peace process will require the surrender of weapons in the hands of the rebels and a mechanism to ensure that such an agreement is fulfilled.

The Australian government, which provides A\$300-400 million a year and will do so at least through 2004-2005, is involved in the negotiations for a peace pact. Peace may now be more achievable than before since the current national government has agreed to Bougainville's autonomy in principle, although its terms are not known. Accommodating the wishes of the rebel province may require changes in PNG's constitution and that may require a national consensus, further delaying the peace process.

A permanent settlement in Bougainville will pave the way for the overall political and economic stability needed in PNG to sustain economic growth and financial stability. Preventing future rebellions, however, requires a much more active dialogue between the national and provincial governments. At the same time, more rapid economic growth that raises both the stock of national wealth and the flow of income will facilitate a more equitable distribution of both, thereby further weakening the potential for economic and social conflicts.

The details of rebuilding the Bougainville economy and subsequent political and economic arrangements are to be worked out in the months and years ahead. Major unanswered issues include the degree of autonomy Bougainville seeks, the means of returning to economic stability and the cost of rebuilding the island's infrastructure and severely damaged economy. Meanwhile, as peace and tranquility return to Bougainville, the provincial and national governments are hoping to strengthen the province's and PNG's political institutions, knowing that strong institutions are critical to attracting the foreign capital needed for rebuilding not just Bougainville but the entire PNG economy.

I.4 The Law and Order Problem

Urban crime became a major problem in the 1980s and 1990s. In 1991, the Parliament passed laws to combat crime, including the death penalty and the tattooing of the foreheads of convicted criminals. Still, crime and a general disregard for law and order remain major concerns in urban areas, especially in Port Moresby. Random violence in the national capital district and other urban areas from time to time generates adverse publicity in global as well as regional media. Meanwhile, security is a growing component of the total cost for businesses and expatriate labor. In fact, the extra cost security adds to total cost is often cited by business to be among the major constraints to

doing business in PNG.⁴

A 1997 study showed that while the direct cost of the law and order problem may be only three percent of total cost, indirect cost is a much higher component of total business cost.⁵ Direct law and order cost includes costs of security personnel and equipment; indirect costs are those arising from management time and other resources devoted to preventive and remedial actions. Among the notable direct costs is that from loss of goods and the disruption of services. By one estimate, 30 percent of the coffee crop in 1997 (about K100 million) was not marketed because of the risk of robbery.⁶

Private security is generally effective but it has become a notable extra cost item for businesses in PNG, adding to the risk premium attached to doing business in the country. The risk premium borne by businesses is then passed on to final users in the form of higher prices of products.

The crime problem will most likely continue until rural migration to cities subsides, and this will happen when rural people have reasons to stay where they are. A decline in urban crime can best be achieved when there are more jobs in both rural and urban areas, and more jobs can be created when more of the country's income from minerals, oil and gas is reinvested in expanding the economy's productive capacity. With a stable political environment and financial market and steady economic growth, the crime problem can be expected to diminish.

Despite the law and order problem, PNG's economy has returned to growth after a few years of stagnation and decline, and now that the Asian financial crisis and the 1997-98 drought are over, the prospect of higher sustained economic growth is much better than it was in the last half of the 1990s. Further, Port Moresby has signaled its desire to deal with the law and order problem. The government will not eradicate the problem any time soon, but a commitment to dealing with it is a necessary beginning.

I.5 Markets versus Traditions

Among the hotly debated issues in the Pacific island economies is the land tenure system. Most Pacific Island economies have both freehold and communally-owned lands. In markets such as PNG where the bulk of the land is owned communally, the small freehold land market is limited to urban areas.

The commodity approach of the open market system in which a mutually agreed-upon price satisfies both buyers and sellers does not apply, since land is a perpetual source of sustenance rather than a commodity and, as such, is often an integral part of the traditional culture. Under these

circumstances the market system and the communal system of ownership, use, rent rate and disposal of land are in conflict.

A systematic approach to the land market requires, first, a much better understanding of these two systems and, second, a search for a middle ground because neither system is sufficient to meet the needs of landowners and land users under these conditions.

Markets work best if prices alone determine the terms of exchange, and only an unconstrained exchange can produce an optimal price. This is the essence of the pure, efficient market theory, predicated on the assumption that exchange occurs freely and that any commodity, including land and labor, can be exchanged at a mutually-agreed upon price. Imposition of constraints, the theory holds, distorts the exchange process and prevents the establishment of a market-clearing, or best price, which is the price that allocates resources efficiently.

Constraints in the marketplace cause distortion, while scarce resources need to be allocated efficiently. This is why market economies emphasize openness and free exchange. Although there are no pure market economies, those governed by markets (prices) have generally performed better than those ruled by dictates (constraints). Socialism's collapse in the Soviet states at the end of the 20th century showed convincingly that the more constraints markets are subjected to, the more pervasive the distortions and the more severe the failure and ensuing economic dislocations.

There is a more fundamental issue underlying market economies and market behavior, and that is the concept of liberty and freedom of choice. In its pure sense, freedom of choice would enable rational persons to make the most efficient decisions consistently, with the requirement that markets be totally unconstrained. A corollary of this proposition is that the most efficient decisions would also require the most complete information about the variables in question. The final outcome under certainty and complete information would be the most efficient.

But as history teaches, totally unconstrained behavior, although in theory maximally efficient, may also produce excesses unacceptable to society as a whole. To ameliorate the negative impact of excessive behavior, either by individuals or groups, various constraints have been put in place mainly, in the modern Western tradition, in the form of laws. Again, as experience has shown, laws work best if they apply to all.

The mix of market principles and legislation governing behavior in the market place is the essence of a modern market economy and an open and democratic society. The question is: can a pure market paradigm work as the model for an economy such as PNG with its strong traditional structure? The answer is "no," because market institutions, which are both imported and relatively new to PNG, are in conflict with what is, by all accounts, a highly traditional economy based on communal customs. Among the most important, even sacred, of the communal traditions is the collective ownership and treatment of land, which is seen not as a commodity but as a perpetual source of sustenance for

⁴AusAid, *The Economy of Papua New Guinea: 1999 Report*, p. 26.

⁵Institute of National Affairs, "Cost Structures in Papua New Guinea," Discussion Paper No. 69, SalPress, Boroko, NCD, Papua New Guinea April 1997, p. 1.

⁶AusAid, *The Economy of Papua New Guinea: 1999 Report*, p. 27.

what is by far the largest segment of the community.

Land ownership in PNG offers an instructive example of why traditional customs stand in the way of a modern capitalist economy. About 97 percent of land in PNG is collectively owned. Collective ownership of the land, the main institution of the traditional system, ensures that no one can exchange the land for individual gain. Alienating land is tantamount to losing the only secure source of livelihood. It is reasonable to argue that if the land were offered for sale, buyers, most likely with cash offers from outside, would purchase it and treat it as a commodity. Since there is no other significant source of income in the mostly traditional economy, selling this source of sustenance would amount to economic and financial deprivation. For this compelling reason, most Pacific Island economies have not embraced the market approach to land ownership and tenure.

It is because of the fear of loss of land that the traditional land tenure systems of the Pacific have laws to prohibit land ownership by outsiders. Imposing this constraint on the land market, however, makes the market inefficient and prone to distortion, which may lead to corruption. With an efficient market system and price allocation of land among buyers effectively unavailable, the best resolution to the PNG land tenure issue is to establish a system as close to the price system as is possible. Such a system calls for long-term leases, and these are already the practice in parts of PNG and many other Pacific economies.

Prohibiting the sale of land to outsiders while still attempting to increase production, consumption and distribution by means of foreign capital puts the market system and the traditional system in an irreconcilable conflict. As a result, calls for land tenure reform often go unanswered. The challenge for both market and traditional decision-makers is to find a land lease system that would make it possible to free land from communal use for commercial use while still preserving its perpetual ownership for the communal group. By its very nature, any middle ground causes distortion which can only be minimized by a set of open and explicitly defined rules of engagement.

Examples of communal land tenure reform, including drawing initial boundaries, mapping, designating lawful owners, establishing mechanisms for entry into legally-binding long-term lease contracts and managing defaults, have been adopted in the Commonwealth of the Northern Mariana Islands and Palau. It has taken some time and effort to make these systems work, but the results are generally encouraging.

Both landowners and investors recognize that allowing land use exchange rights for communal lands are critical to market principles and especially to attracting large amounts of capital to create enterprises that, in turn, create income and taxes. To accelerate the growth of enterprise, landowners, businesses and governments have worked to produce some examples of these solutions.

The island economies with traditional systems closest to PNG and facing the same land use and tenure issues are Fiji, New Caledonia and Vanuatu. Governments and quasi-

public agencies in these markets have also made it possible to arrange for long-term leases of large tracts of lands for various uses.

Among the best examples in PNG is New Britain Palm Oil Limited, operator of the country's largest commercial palm oil plantation, with over 22,800 hectares (over 56,000 acres) under cultivation and plans for various expansions in the years ahead. Most of the land under New Britain Palm Oil's palms was leased for 99 years in the 1960s from both communal and other owners, with the government's mediation. This is not the perfect market method, especially for small land holdings, but it has worked for large holdings. Similar arrangements can be made for all landowners.

As a major step toward a national land tenure reform in PNG, there is the need for a national standard of fixed-term land leases that would make land use and lease exchanges as marketable as are land titles in freehold land markets. This can be accomplished by passing a uniform land lease law that would apply to both private and collective land leases and by the establishment of a national land court. Freehold lands would not be subject to any of the new laws and regulation applying to communal lands.

The law would require that all lands in the country be surveyed, mapped and registered with the land court with lawfully designated owners who may engage in legally-binding leases of up to, say, 99 years. With such a system in place, land sale would give way to land lease and both landowners and users would find the optimal uses for all lands. This system would also make it possible to identify "highest and best use" for all lands in PNG, make the best use of them and earn the most from them.

II. MACROECONOMIC REVIEW & FORECAST

II.1 Introduction

Macroeconomic and financial instability in PNG arises from two sources: (a) structure and performance of the economy, and (b) liquidity problems arising from both internal and external conditions that hamper the ability of government and businesses to meet their financial needs. Internal liquidity problems impede the government's ability to maintain monetary and financial stability and this has important implications for price, exchange rate and foreign trade stability. External liquidity ills also have serious impact, especially because import levels and export earnings are critical factors for economic growth.

An example of instability arising from PNG's economic structure is its reliance on exports of primary commodities, including crude oil, which usually command low and widely fluctuating prices in global markets. Now that oil prices have increased significantly over the last 18 months, PNG will benefit from high prices. However, changes in oil prices are by their nature transitory and, therefore, of little long-term effect.

PNG's MAJOR ECONOMIC AND FINANCIAL INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Nominal GDP (\$US million)	3,219.3	3,786.9	4,377.3	4,974.8	5,354.6	4,613.5	5,221.5	4,927.1	3,820.8	3,648.7	3,754.4
Nominal GDP Per Capita (\$US)	870.1	1,004.5	1,137.0	1,269.1	1,338.6	1,133.5	1,186.7	1,094.9	830.6	776.3	781.6
Nominal GDP (Millions of Kina)	3,075.7	3,605.2	4,222.3	4,867.2	5,381.5	5,888.3	6,881.3	7,063.9	7,863.4	9,263.1	11,087.9
Nominal GDP Growth (%)	1.0	17.2	17.1	15.3	10.6	9.4	16.9	2.7	11.3	17.8	19.7
Nominal GDP Per Capita (K)	831.3	956.3	1,096.7	1,241.6	1,345.4	1,446.8	1,563.9	1,569.8	1,709.4	1,970.9	2,308.3
Real GDP (1983 Prices, K mill)	2,350.8	2,575.4	2,931.5	3,465.1	3,671.0	3,549.4	3,823.9	3,674.6	3,536.1	3,670.5	3,843.0
Real GDP Growth (%)	(3.0)	9.6	13.8	18.2	5.9	(3.3)	7.7	(3.9)	(3.8)	3.8	4.7
Real GDP Per Capita (K)	635.4	683.1	761.4	884.0	917.8	872.1	869.1	816.6	768.7	781.0	800.1
Real GDP Per Capita Growth (%)	(2.5)	7.5	11.5	16.1	3.8	(5.0)	(0.3)	(6.0)	(5.9)	1.6	2.4
Population & Employment											
Population (millions)	3.70	3.77	3.85	3.92	4.00	4.07	4.40	4.50	4.60	4.70	4.80
Population Growth (% per year)	1.9	1.9	2.1	1.8	2.0	1.8	8.1	2.3	2.2	2.2	2.2
Employment Index (June 1989=100)	94.6	91.1	91.3	91.4	98.1	93.5	100.5	100.3	96.8	101.5	106.6
Employment Growth (%)	(4.7)	(3.7)	0.2	0.2	7.3	(4.7)	7.5	(0.2)	(3.5)	4.9	5.0
GDP by Expenditure (Mill K)											
Private Consumption	1,816.0	2,121.0	2,143.0	2,045.6	2,239.7	2,453.6	3,375.4	4,118.8	4,694.3	—	—
Government Consumption	763.9	852.7	1,004.5	1,199.3	1,001.4	1,005.8	1,369.9	1,361.3	1,406.6	—	—
Gross Fixed Capital Formation	772.8	1,010.1	914.1	900.8	1,012.0	1,150.3	1,185.6	1,079.4	1,088.6	—	—
Change in Stocks	(21.0)	(22.0)	70.0	(42.5)	141.7	148.9	374.8	408.9	306.7	—	—
Exports of Goods & Services	1,249.7	1,523.9	2,020.7	2,562.2	3,030.6	3,674.5	3,575.2	3,312.0	3,942.3	4,985.3	5,125.2
Imports of Goods & Services	1,505.7	1,880.5	1,930.0	1,798.2	2,043.9	2,544.8	2,999.6	3,216.5	3,575.1	3,059.1	3,283.6
GDP by Expenditure (%)											
Private Consumption	59.0	58.8	50.8	42.0	41.6	41.7	49.1	58.3	59.7	—	—
Government Consumption	24.8	23.7	23.8	24.6	18.6	17.1	19.9	19.3	17.9	—	—
Gross Fixed Investment	25.1	28.0	21.6	18.5	18.8	19.5	17.2	15.3	13.8	—	—
Change in Stocks	(0.7)	(0.6)	1.7	(0.9)	2.6	2.5	5.4	5.8	3.9	—	—
Exports of Goods & Services	40.6	42.3	47.9	52.6	56.3	62.4	52.0	46.9	50.1	—	—
Imports of Goods & Services	49.0	52.2	45.7	36.9	38.0	43.2	43.6	45.5	45.5	—	—
Fiscal Indicators (Mill K)											
Government Revenues & Grants	998.0	1,026.0	1,126.0	1,310.7	1,445.5	1,721.5	1,897.7	2,024.0	1,991.2	2,569.0	2,866.7
Government Spending	1,089.0	1,188.0	1,358.0	1,594.2	1,570.4	1,755.0	1,860.7	2,008.6	2,128.6	2,801.3	3,081.8
Government Budget Balance	(91.0)	(162.0)	(232.0)	(283.6)	(124.9)	(33.5)	37.0	15.4	(137.4)	(232.3)	(215.1)
Money, Inflation & Exchange Rates											
M1 (Narrow Money, Mill K)	353.3	458.0	509.1	527.5	571.3	645.9	864.9	919.5	1,021.3	1,233.7	1,114.6
M3 (Broad Money, Mill K)	1,334.4	1,505.9	1,647.9	1,811.4	1,860.1	2,066.0	2,736.4	3,101.1	3,212.3	3,500.3	3,547.3
6-Month Treasury Bill Rate (%)	10.5	10.5	6.5	6.0	10.8	21.5	9.2	14.5	23.9	20.4	16.1
Commercial Bank Avg. Loan Rate (%)	—	—	13.6	9.2	10.0	15.4	10.2	10.6	20.2	18.2	17.7
Consumer Price Inflation (%)	7.0	7.0	4.0	5.0	6.5	3.0	17.0	12.0	4.0	14.0	15.0
Exchange Rate: \$US/Kina	1.05	1.05	1.04	1.02	1.00	0.78	0.76	0.70	0.49	0.39	0.34
Balance of Payments (Mill K)											
Current Account Balance	(88.0)	(144.0)	94.0	632.0	576.0	859.0	411.0	(167.0)	124.0	367.0	292.0
Trade Balance	86.0	75.0	607.0	1,437.0	1,346.0	1,800.0	1,338.0	950.0	1,476.0	2,246.0	2,668.0
Services Balance	(287.0)	(466.0)	(699.0)	(847.0)	(781.0)	(1,034.0)	(1,022.0)	(1,204.0)	(1,539.0)	(1,929.0)	(2,308.0)
Transfers	113.0	247.0	186.0	42.0	11.0	93.0	95.0	87.0	187.0	50.0	(68.0)
Capital Account Balance	207.0	60.0	(146.0)	(701.0)	(627.0)	(556.0)	58.0	30.0	(364.0)	(170.0)	308.0
Errors & Omissions	(111.0)	3.0	(16.0)	(27.0)	3.0	(59.0)	(37.0)	14.0	(23.0)	(29.0)	64.0
Overall Balance	8.0	(81.0)	(68.0)	(96.0)	(48.0)	244.0	432.0	(123.0)	(263.0)	168.0	664.0
International Reserves (\$US Mill)	403.0	323.1	238.6	141.5	96.1	261.4	583.9	362.7	192.9	205.1	175.7
Import Cover (Months)	3.1	2.0	1.4	0.9	0.6	1.6	3.1	1.9	1.3	2.0	1.9
Total Public Debt Outstanding (Mill K)	1,470.1	1,566.7	1,945.2	2,320.0	2,961.2	3,324.2	3,780.8	4,418.0	5,177.6	5,834.1	5,141.8
Domestic Debt (Mill K)	406.4	555.9	824.4	1,036.6	1,424.3	1,605.7	1,969.5	2,251.7	2,473.0	2,021.3	1,774.6
Foreign Debt (Mill K)	1,063.7	1,010.8	1,120.8	1,283.4	1,536.9	1,718.5	1,811.3	2,166.3	2,704.6	3,812.8	3,367.2
Total Debt as a Share of GDP (%)	47.8	43.5	46.1	47.7	55.0	56.5	54.9	62.5	65.8	63.0	46.4

Note: Figures for 2000 are as of June.

Sources: International Monetary Fund, *International Financial Statistics* (various); Bank of Papua New Guinea, *Quarterly Economic Bulletin* (various); Economic Policy Unit, Treasury & Corporate Affairs, *Monthly Economic Monitor* (various)

An example of liquidity problem arising from external conditions beyond the control of the national government was the drop in commodity prices in 1997-98, coupled with severe drought which led to a decrease in agricultural output. In addition, devaluation of the Kina caused by regional and global economic forces not only raised import prices but worsened balance of payment problems. The combined adverse impact of these developments prompted the World Bank and IMF to come to PNG's aid.

To the degree that PNG earns most of its foreign exchange income from commodities and commodity prices fluctuate, often without advance signals, some instability in its foreign exchange income can be expected in both the short and long terms. However, any detrimental impacts can be lessened by the avoidance of public sector deficits that put pressure on inflation and exchange rates and, in the end, on the balance of payments.

Recent problems arising from poor fiscal management have been well-known. Now that the World Bank, IMF and Australia are engaged in aiding PNG out of its current financial problems, the time has arrived for putting in place stronger measures to restore long-term financial stability to PNG. Political, financial and economic uncertainties have diminished in PNG since the new government came to office in July 1999. The Prime Minister is a former governor of the Bank of Papua New Guinea, the central bank, managing director of PNG Banking Corporation and a businessman with business and government background going back to the 1970s. The formal Opposition party has five members.

Pointing to the country's struggle with its financial problems, the Prime Minister warned the Parliament in mid-October 2000 that "almost all of the country's statutory bodies are bankrupt."⁷ The national government has also had to suspend or remove from power provincial governors and others on charges of poor management.

Among the constructive steps the new government has taken is a new law giving the Bank of PNG autonomy. As an autonomous unit, the Bank of PNG now focuses monetary policy on price stability which allows markets to guide interest and exchange rates. A critical secondary benefit of the central bank focusing on its basic work will be up-to-date and reliable macroeconomic data. Presently there are at least four or five sets of GDP data floating in Port Moresby. (The data used for this report are those from the Bank of PNG; they are not complete and up to date.⁸ The lack of timely and accurate data, especially on demographic change and national economic

accounts, as yet continues to present a barrier to objective analysis.)

Meanwhile, the World Bank and IMF have pledged structural reform loans and other financial aid for PNG totaling \$205 million. The IMF will supply \$115 million, of which \$24 million was approved for release in mid-October 2000.⁹ Politically, PNG will remain volatile until the next election, scheduled for June-July 2002. However, the economy is improving.

II.2 GDP Growth

PNG was expected to grow rapidly following independence in 1975. This expectation was based on the assumption that a large land mass rich in minerals and natural resources and a relatively small population were an ideal mix for rapid and consistent growth. However, lack of adequate skilled labor and, more important, the institutional structure essential to an open market economy have hampered PNG's economic growth prospects.

Despite its resources, a large pool of expert expatriate labor and a large exclusive economic zone, PNG's economy has grown slowly and erratically, especially in the 1990s. Compounding the slow growth problem in the 1990s were the Bougainville secession, minor disturbances in other provinces and poor fiscal management. Together, they caused political, financial and economic instability which together led to notable slowing down in capital formation (investment).

Based mainly on official estimates and projections expressed in Kina and converting them to US dollars using current exchange rates, PNG's total GDP was US \$3.7544 billion in 2000, yielding a per capita GDP of US \$782. When it was first floated in 1994, the Kina almost equaled the US dollar and made quantities expressed in Kina equal to those expressed in US dollars. This temporary parity of the Kina and the US dollar was coincidental, not reflective of the underlying economic and financial parameters. Once floated, the Kina depreciated against the dollar. As a result, PNG's total GDP of \$5.3546 billion and its per capita GDP of \$1,339, in US dollars in 1994, have so far remained the country's highest.

In 1994-2000 total GDP expressed in US dollars dropped 29.9 percent and per capita GDP dropped 41.6 percent. These large declines resulted from the Kina depreciating against the dollar, not because of large decreases in output or losses in purchasing power. In 1994-2000, the Kina depreciated against the dollar 66.6 percent.

The Kina lost some of its value against the US dollar after 1994, but the depreciation became intense in 1997-2000 when PNG's political problems, poor financial management and economic decline all became severe. Coincidentally, in 1997-2000, partly because of the Asian financial crisis and partly because of strong growth of the US economy, most

⁷The *Australian Financial Review*, "Kaupa Shines a Light for PNG to Follow," Monday, October 23, 2000.

⁸The Bank is working backwards to revise PNG's macroeconomic accounts. It has done this so far for 1993-98, and the 1999-2000 data will be available in 2001. Starting in 2002, the data are expected to be generated within the calendar year. BOH GDP data for 1990-92 are from the old series and, therefore, are not comparable to the 1993-98 data. The 1999-2000 GDP data are estimates and projections from various sources.

⁹IMF, "IMF Completes First Review of Papua New Guinea Program and Approves US \$24 Million Credit," News Brief No 00/94, Washington, DC, October 13, 2000.

world currencies, with the notable exception of the Japanese yen, depreciated significantly against the dollar. Both the Australian and New Zealand dollars, for example, hit record lows against the US dollar in 2000.

PNG's GDP and per capita GDP figures expressed in US dollars are consistent with those from other sources. However, examining PNG's GDP components and other economic quantities in Kina, its own currency, provides a more realistic review of economic conditions and performance in PNG. US dollar figures are useful mainly for international comparisons.

In 2000, total GDP was an estimated K11.0879 billion, up 19.7 percent from 1999, and per capita GDP was K2,308, up 17.1 percent from 1999. Consumer price inflation was 14.0 percent in 1999 and 15.0 percent in 2000, permitting small gains in both total and per capita real GDP. Real GDP (in 1983 prices) in 2000 was K3.8430 billion, up 4.7 percent from 1999.

In 1990-2000, real GDP grew from K2.3508 billion to K3.8430 billion. Compounded annual growth averaged a respectable 5.0 percent for total real GDP and 2.3 percent for real per capita GDP in 1999-2000. Real per capita GDP growth fell short of the average 2.6 percent population growth rate during the same time. Real per capita GDP in 2000 was K800.1, higher than K635.4 in 1990 but notably below the 1994 peak of K917.8.

Real GDP growth in 1990-2000 was uneven and erratic. In that period, PNG experienced three recessions: in 1990, 1995 and 1997-98. The losses in real GDP ranged from 3.0 percent in 1990 to 3.9 percent in 1997. These were, by most accounts, mild recessions. Growth in the intervening periods ranged from a high of 18.2 percent in 1993 to 3.8 percent in 1999.

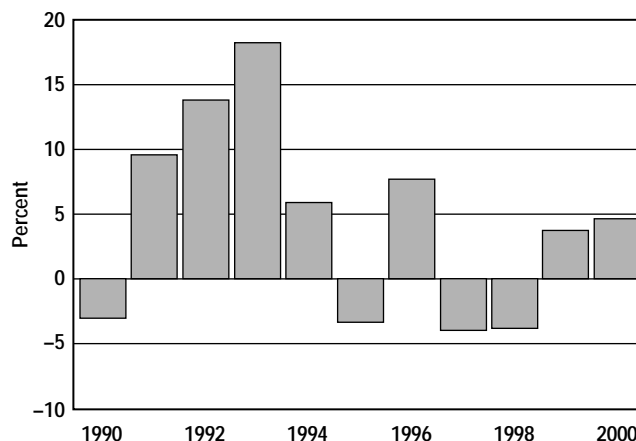
It is not clear exactly how much of the fluctuation was the result of uncontrollable variables, but poor fiscal and monetary controls sometimes exacerbated these problems. It may be not be possible to engineer a totally smooth real GDP growth trend, but it should be practicable to stabilize those parts that are directly affected by public policy.

Given PNG's resources and population growth, a real GDP growth of more than five percent a year would be required to sustain the current standard of living. With a more dynamic approach to economic growth, emphasizing capital formation and skill development, PNG should easily be able to grow 10 percent or more for several years. Whether such an objective can be realized is a function of both markets and public policy.

II.3 Economic Structure

In 1990-2000, GDP composition showed only small relative changes. Agriculture, forestry and fisheries (AFF) together dominated the economy with 25.1 percent of GDP in 2000, up from 24.0 percent in 1999. Through the decade, AFF averaged 26.3 percent, ranging from a high of 29.0 percent in 1990 to 24.0 percent in 1999. Some of the decline in the relative share of AFF in 1998-99, when it dropped

REAL GDP GROWTH RATES



below 25.0 percent for the first time, was the result of price decline and some was attributable to quantity declines.

With commodity prices changing unpredictably and the Kina losing or gaining value against foreign currencies accordingly, commodity components of AFF such as copra, coffee and tea, cocoa, palm oil, rubber and logs will most likely continue to fluctuate in the near term. The price of PNG coffee, for example, in the first quarter of 2000 was up 21.5 percent from the previous quarter. Most of the gain was the result of the Kina depreciating against the dollar (more Kina per US dollar) and not because of output gains. In fact, coffee prices worldwide were down in the first-quarter of 2000 because of bumper crops in Brazil and Vietnam. PNG's coffee exports in first-quarter 2000 were also down from first-quarter 1999.

Although fluctuations in exchange rates have become a major source of instability in foreign exchange earnings, they are unlikely to have lasting effect on the production and export patterns of PNG's AFF in the long run. AFF's contribution to the domestic economy and exchange earnings will be affected more by how productive and internationally competitive the sector becomes.

The market value of AFF as accounted for in GDP does not represent the subsistence and semi-subsistence economies, the market values of which are unknown. The only substantive knowledge of the subsistence economy is that it supports, directly and indirectly, 85-90 percent of PNG's population. The subsistence economy consists of farming, gathering and fishing. Given these realities, both the formal economy and labor force engaged in it represent a small segment of either PNG's total gross national product or population.

Mining and quarrying (excluding petroleum), the second largest piece of the GDP pie, remained relatively stable in 1990-2000. It averaged 14.9 percent in the decade, ranging from a low of 12.1 percent in 1996 when quantities produced were low to 17.7 percent in 1999 when both quantities and commodity prices strengthened. If capacity remains fixed at current extraction levels, rising

PNG GROSS DOMESTIC PRODUCT (GDP) BY INDUSTRY

<i>K Million (current prices)</i>	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Agriculture, forestry & fisheries	891	937	1,021	1,335	1,546	1,693	1,832	1,872	1,885	2,037	2,210	2,614
Mining & quarrying	452	613	656	635	737	1,086	836	665	1,285	1,504	1,512	1,450
Petroleum	—	—	269	746	629	708	916	729	722	937	801	790
Manufacturing	276	345	390	411	423	497	603	648	693	759	806	921
Electricity & other services	52	59	65	66	73	80	90	92	104	113	119	126
Construction	155	224	211	190	218	196	384	361	458	532	628	817
Commerce	297	359	387	417	436	521	607	669	693	737	762	825
Transport & storage	191	243	234	261	262	318	350	377	409	436	473	540
Finance, real estate properties	23	37	45	46	51	57	70	77	87	98	104	107
Community & social services	551	588	650	711	787	859	884	963	971	916	937	916
Import Duties	188	201	213	198	247	294	341	372	407	435	468	539
Total Gross Domestic Product	3,076	3,606	4,141	5,016	5,409	6,309	6,913	6,825	7,714	8,504	8,820	9,645
As Shares of GDP (%)												
Agriculture, forestry & fisheries	29.0	26.0	24.7	26.6	28.6	26.8	26.5	27.4	24.4	24.0	25.1	27.1
Mining & quarrying	14.7	17.0	15.8	12.7	13.6	17.2	12.1	9.7	16.7	17.7	17.1	15.0
Petroleum	—	—	6.5	14.9	11.6	11.2	13.3	10.7	9.4	11.0	9.1	8.2
Manufacturing	9.0	9.6	9.4	8.2	7.8	7.9	8.7	9.5	9.0	8.9	9.1	9.5
Electricity & other services	1.7	1.6	1.6	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Construction	5.0	6.2	5.1	3.8	4.0	3.1	5.6	5.3	5.9	6.3	7.1	8.5
Commerce	9.7	10.0	9.3	8.3	8.1	8.3	8.8	9.8	9.0	8.7	8.6	8.6
Transport & storage	6.2	6.7	5.7	5.2	4.8	5.0	5.1	5.5	5.3	5.1	5.4	5.6
Finance, real estate properties	0.7	1.0	1.1	0.9	0.9	0.9	1.0	1.1	1.1	1.2	1.2	1.1
Community & social services	17.9	16.3	15.7	14.2	14.5	13.6	12.8	14.1	12.6	10.8	10.6	9.5
Import duties	6.1	5.6	5.1	3.9	4.6	4.7	4.9	5.5	5.3	5.1	5.3	5.6
Total Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: The Australian Agency for International Development, *The Economy of Papua New Guinea: 1999 Report*, p. 115.

prices alone will not be sufficient to make a notable difference in the contribution mining and quarrying make to GDP in the next few years. Opening new mines, especially nickel, and the start of the gas pipeline to Queensland in the next 3-4 years would make a large difference in the role of mining and quarrying in the PNG economy.

Nickel is among commodities that have recently enjoyed relatively high prices. However, while PNG's nickel deposits are of a commercial quantity to justify

extraction, no definitive investment proposals have been offered. This is because nickel mining and processing require large amounts of capital and long periods of capital and cost recovery, sometimes decades. Established producers such as New Caledonia and Australia have the advantage in attracting incremental capital because they already have the infrastructure in place.

Two-thirds of the world's mined nickel goes into the making of stainless steel worldwide. Since the demand for

EXPORT QUANTITIES BY COMMODITY

	Unit	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Minerals & Oil													
Gold	tons	34	58	67	59	56	55	47	44	58	71	79	70
Copper	000 tons	197	192	188	192	207	216	128	78	110	181	174	175
Oil	million barrels	—	—	15	46	43	37	39	28	28	34	29	27
Agricultural													
Coffee	000 tons	63	47	53	63	65	55	62	59	84	54	60	66
Cocoa	000 tons	34	36	39	38	26	31	41	39	26	37	39	40
Copra	000 tons	55	44	48	59	50	64	99	90	58	80	84	88
Copra Oil	000 tons	35	33	35	46	35	33	50	49	53	57	60	63
Palm Oil	000 tons	143	200	206	246	231	187	267	275	213	239	251	264
Rubber	000 tons	2	3	3	4	3	3	3	4	5	5	5	5
Tea	000 tons	5	5	6	6	3	4	9	7	7	5	6	6
Logs	000 m3	990	1,062	1,601	2,375	2,944	2,513	2,607	2,376	1,067	1,800	1,800	2,000
Marine products	000 tons	1	2	2	3	5	6	3	2	10	—	—	—

Source: The Australian Agency for International Development, *The Economy of Papua New Guinea: 1999 Report*, p. 129.

EXPORT VALUES BY COMMODITY

<i>K Million (current prices)</i>	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Minerals & oil	757	1,006	1,372	1,768	1,782	2,436	2,245	1,839	2,456	3,419	3,284	3,443
Gold	393	667	746	682	702	840	774	719	1,228	1,458	1,657	1,796
Copper	349	324	314	256	367	755	387	260	396	853	689	721
Silver	15	15	11	12	10	13	10	8	19	22	9	11
Oil	—	—	301	818	703	828	1,074	852	813	1,086	929	915
Agriculture	206	206	224	271	375	503	578	777	1,021	881	892	836
Coffee	103	80	68	101	205	215	190	326	476	299	330	301
Cocoa	30	34	34	33	29	48	66	73	82	124	131	114
Copra	9	5	12	14	15	27	49	47	39	65	60	55
Copra Oil	12	13	24	20	20	30	51	51	70	89	97	103
Palm Oil	33	53	64	79	78	142	182	207	272	280	245	230
Rubber	2	2	2	3	3	4	4	7	7	12	13	15
Tea	7	5	7	7	4	5	13	10	19	12	16	18
Other	10	14	13	14	21	32	23	56	56	—	—	—
Forestry	80	90	148	410	494	450	480	433	173	—	—	—
Logs	65	81	140	400	483	437	465	409	154	280	340	378
Other	79	91	119	79	10	12	10	10	40	233	179	202
Total	1,187	1,474	2,003	2,928	3,144	3,838	3,778	3,468	3,844	4,813	4,695	4,859

Source: The Australian Agency for International Development, *The Economy of Papua New Guinea: 1999 Report*, p. 127.

nickel is relatively limited while the capital it takes to start new mines is very large, established producers would naturally tend to extract every possible deposit from existing mines rather than open new ones. As competitive as global capital markets are, it would take more than nickel deposits alone to attract the large amount of capital it takes to start a new nickel mine in PNG.

Petroleum, the third largest component of GDP in PNG, was also stable throughout 1990-2000. It averaged 10.8 percent in 1992-2000, ranging from 6.5 percent in 1992 when oil production began to 14.9 percent in 1993 when it peaked. In 2000, it was 9.1 percent of GDP, reasonably close to the average. Without new oil discoveries, oil production will remain stable for the next several years and then diminish as the current reserve is depleted.

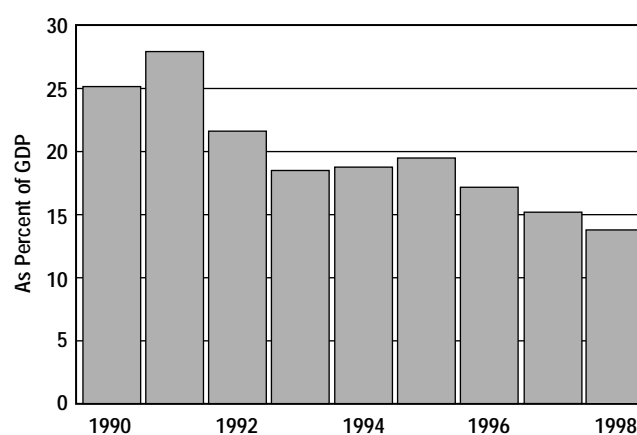
Following the production of petroleum in 2000 was manufacturing. It amounted to 9.1 percent of GDP in 2000, and averaged 8.8 percent in 1990-2000, ranging from 7.8 percent to 9.6 percent. Just as petroleum, manufacturing which is dominated by production and processing of food and other basic manufactured goods mainly for domestic consumption, will remain to be stable in the next several years.

Among the service pieces of the GDP pie, community and social services, mostly public services, dominated with 10.6 percent of GDP in 2000. They averaged 13.9 percent for the decade, ranging from a high of 17.9 percent in 1990 to a low of 10.6 percent in 2000. For services to become a smaller piece of the GDP pie is somewhat unusual, but understandable in PNG since overall government as a share of GDP has declined over the last decade. In 1990, total government spending as a share of GDP was 24.8 percent, consistent with other economies in the region. In 1998, the last year for which official figures are available, it was down to 17.9 percent.

Transport and communication is a relatively small component of GDP but of significant meaning in the context of economic change. The sector ranged from 6.7 percent of GDP in 1991 to 4.8 percent in 1994, averaging 5.5 percent for the decade. The fact that transport and communication changed so little, actually declining a bit as a share of GDP in 1990-2000, is reflective of little change in the industry's infrastructure and signals slow change in the direction the country needs it most. It is doubtful that PNG's economic growth can be sustained without a developing transport and communication sector.

The recent decline in total fixed capital formation is another indicator with significant economic implications for the present and future. As a share of GDP, total fixed investment dropped by nearly half, from 25.1 percent in 1990 to 13.8 percent in 1998. Such a sharp drop in capital

GROSS FIXED INVESTMENT



formation reflects not only a decline in current productive capacity, it also signals a decline in future productive capacity as well as diminished confidence in PNG with its large reserves of minerals. In fact, among the most significant comparative economic advantages of PNG has been its rich natural resource mix which, without adequate capital and substantial foreign expertise, will remain unused.

With a higher multiplier, or ripple effect, than private consumption or public spending, capital formation is critical to economic vitality, job creation and productivity growth. Political and economic instability has affected PNG's ability to attract capital without which the economy's productive capacity cannot expand. PNG needs large sums of capital to exploit the range of its natural resources, from fish and forests to minerals.

II.4 Employment

The lackluster growth in Bank of PNG's employment index in the 1990s reflected weaknesses in the economy and its industrial makeup. In 1999, the formal private (money economy) employment index was only slightly higher than its base year of 1989, with wide variations in between. The details of the index's underlying components (the numbers of workers in each category and their changes) are unavailable, but the index levels themselves show little overall progress in employment in the money economy. With population growing an average 2.6 percent a year (124,800 new persons), it will take more rapid growth in jobs in the money economy to absorb all new entrants to the labor market.

PNG's labor force (persons aged 15-64) numbers well over two million. However, only an estimated 220,000 people work in the formal sector (those on formal payroll), of whom about 60,000 work in the public sector. In effect, payroll employment in the money economy is available to

only 10 percent of the labor force. If indeed correct, this ratio would be one of the lowest ratios of this type in the Pacific and lower than that of any other major economy in the Pacific. Nevertheless it appears consistent with the observation that 85-90 percent of PNG's population still depends on the subsistence and semi-subsistence economies.

Given this picture of the economy, its structure and its potential for jobs and employment growth, PNG produces considerably below its potential output, especially in commercial agriculture. Palm oil production is one of the areas where the country's vast potential has been turned into production, foreign exchange, taxes and jobs. New Britain Palm Oil Limited (NBPOL), PNG's largest and fast-growing palm oil firm, offers an example of an enterprise that meets many of the criteria for economic and social development most compatible with the existing environment.

Established in 1967, New Britain Palm Oil Limited has 22,800 hectares (over 56,000 acres) under cultivation and plans various types of expansion in the years ahead. Some of the lands turned into plantations had been unused and some were of only marginal value for other uses. The company operates three oil plants and a fourth is under construction. It is looking into building its own refining plant which would give it the advantage of being able to sell refined oil directly to its customers. Most important in terms of PNG's labor market, the company employs over 6,000 workers, of whom a few are expatriates.

The plantation is undoubtedly the highest and best use of land since alternative uses are extremely limited. The plantation has changed the natural environment minimally while adding thousands of large trees to the already lush plantation setting. By creating jobs and an outlet for small-holding producers who would otherwise have no market for their oil palms, the plantation has been instrumental in creating the town of Kimbe, on the northern

INDEXES OF FORMAL PRIVATE EMPLOYMENT (JUNE 1989=100)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Formal private employment	94.6	91.1	94.0	91.4	98.1	93.5	100.5	100.3	98.0	100.9
Employment by industry										
Retail	87.8	86.2	85.0	83.9	88.4	92.6	94.8	103.9	112.1	117.2
Wholesale	87.3	81.4	86.0	83.9	90.6	82.3	82.1	82.7	82.8	85.4
Manufacturing	94.8	95.2	102.0	103.7	120.1	110.2	114.7	119.2	123.9	129.0
Building & construction	106.8	81.1	77.0	73.6	77.8	69.6	89.4	85.8	74.1	69.7
Transport	111.5	104.4	94.0	90.7	95.2	89.6	96.5	99.0	95.2	91.4
Agriculture, forestry & fishing	89.0	89.2	97.0	95.1	101.1	87.4	90.8	83.3	75.7	78.7
Financial & business	109.2	103.3	105.0	104.3	102.3	111.0	116.1	127.3	139.0	146.9
Mining	100.7	99.8	107.0	106.4	104.9	112.2	116.2	116.7	135.9	137.6
Employment by region										
National Capital District	102.0	94.9	91.5	88.7	96.8	98.7	104.0	109.8	110.2	110.0
Lae	104.0	98.7	98.9	96.4	107.6	105.1	103.7	109.3	112.3	115.5
Islands	85.0	77.8	76.2	72.3	71.1	61.6	69.0	73.5	64.0	63.5
Highlands	83.0	91.8	114.7	113.1	125.0	126.3	139.9	106.0	112.8	114.6
Madang-Wewak	107.0	108.5	117.0	109.4	102.1	100.2	110.6	109.5	129.7	149.2
Other regions	87.0	83.3	81.8	92.4	106.0	89.5	96.7	103.0	89.1	100.3

Source: Bank of Papua New Guinea, *Quarterly Economic Bulletin*, June 2000, p. S42.

coast of the West New Britain Province's main island.

Palm oil exports have shown rapid growth in recent years and are now the second most important tree crop export, following coffee. In 1994-99, palm oil exports increased from K77.5 million to K337.9 million.¹⁰ Yields from PNG's oil palm plantations are among the highest in the world. This is the result of both favorable climatic conditions and improved varieties and modern and efficient management systems.

While NBPOL is the country's largest producer, perhaps accounting for 55-60 percent of total output, there are other producers who have contributed to the industry's growth and to the creation of local jobs and tax revenues. That palm oil is a vegetable oil of universal demand makes it a permanent major foreign exchange earner for PNG.

To the degree that land availability and other environmental conditions allow, tropical tree crops offer both employment and foreign exchange avenues and cause minimal disruption in the local economic and social settings. Regardless of how modern palm oil plantations may be, they will remain labor-intensive in the foreseeable future. This is one of their main advantages to rural areas in PNG where alternative economic activities compatible with local social and economic conditions are few.

II.5 Fiscal Management

During the last decade, 1996 and 1997 were the only years in which PNG showed fiscal discipline. The small surpluses in those years resulted from IMF and World Bank pressures on the government to exercise fiscal discipline and put in place a mechanism that would ensure sound fiscal management in the long run. That discipline disappeared as a combination of unfavorable conditions in 1998 forced the government to spend more than it collected. In 1990-2000 deficits were once again relatively large but remained below 3.0 percent of GDP.

The 1999-2000 deficits are considered not too high by global standards, especially for developing economies where public capital and consumption spending are not always clearly separated. When the deficits are perceived to be caused by increases in public capital spending, they are generally viewed with less skepticism by both donors and business.

Donors and capital markets expect that solving PNG's immediate financial problems will pave the way for putting in place structural and legal constraints on the government to prevent a repetition of the deficit buildup. The proposed programs are similar to those PNG and the World Bank agreed to during the 1994-95 financial crisis. Under that agreement, PNG was to keep its budget balanced and inflation under control, its borrowing limited to its debt service capacity (payments coming out of export earnings rather than further borrowing) and its central bank free from underwriting unplanned deficits. However, external

economic and financial problems coupled with a new government's desire to help provincial governments caused Port Moresby once again to get into financial trouble.

As outlined in the 2000 budget, the government expected both real GDP growth and fiscal surpluses in 2001-2003 because it anticipated more favorable economic conditions. The main assumption behind the 2001-2003 forecast was that the IMF and World Bank aid would be in place to stabilize government's cash flow, build up international reserves to prudent levels (e.g. 5-6 months of import cover) and strengthen PNG's balance of payments. These developments, in turn, would stabilize the Kina, which has depreciated recently. The expectation is that these favorable changes would once again create the environment in PNG to attract large sums of foreign capital which are needed to exploit its rich natural resources.

The most notable projects in need of capital are the gas pipeline to Queensland and the nickel mine, which has yet to attract seriously interested prospective investors. Without sufficient progress on the \$3.5-billion gas pipeline, the nickel mine is unlikely to attract the \$800-900 million it will take to develop it.

II.6 Monetary Policy, Balance of Payments and Debt

In his semi-annual Monetary Policy Statement in July, the Governor of the Bank of PNG stated that price (and exchange rate) stability was the Bank's main objective.¹¹ Others were stability of the financial system, macroeconomic stability and promoting an efficient payment system in PNG. The central bank governor maintained that the banking act had made Bank of PNG autonomous and independent. However, in the absence of sustained fiscal discipline, there is little monetary policy alone can do to achieve price and exchange rate stability.

To the degree that a fiscal deficit is dissaving which crowds out private investment because the central bank can raise interest rates to meet government's immediate cash flow needs, monetary policy becomes a tool for keeping government afloat rather than a tool of price, exchange rate and macroeconomic stability. PNG's fiscal and monetary management through most of the 1990s was shaped by such government needs. Fiscal deficits during most of this period forced successive governments to fund them by borrowing from Bank of PNG. The result was that although financing the deficits increased domestic liquidity and helped increase imports, they depleted international reserves and put downward pressure on the foreign exchange value of the Kina.

These circumstances led to high interest rates, loss of confidence in the Kina and imported inflation as devaluation of the Kina caused import prices to increase more rapidly.

¹⁰Bank of PNG, *Quarterly Economic Bulletin*, June 2000, p. S31.

¹¹Bank of Papua New Guinea, "The Semi-annual Monetary Policy Statement by the Governor of the Bank of Papua New Guinea, Mr.L. Wilson Kamit," July 14, 2000. This statement is now required by the Central Banking Act of 2000, enacted in June 2000.

GOVERNMENT DEBT OUTSTANDING

<i>K Million (current prices)</i>	1990	1991	1992	1993	1994	1995	1996	1997	1998
In current prices									
Domestic debt	406	556	823	1,038	1,425	1,606	1,970	2,252	2,473
By creditor									
Bank of Papua New Guinea	228	247	376	308	612	634	622	951	1,327
Commercial banks	115	227	363	498	433	756	1,132	1,062	820
Superannuation funds	44	68	69	73	121	102	81	87	86
Other financial institutions	18	13	14	35	64	56	75	77	101
Commodity stabilization funds	—	—	—	120	194	—	—	—	—
Public authorities	—	—	—	—	—	—	—	—	—
Government-funded agencies	1	1	1	1	—	—	5	22	48
Other	—	—	—	3	1	57	54	53	92
By source									
Inscribed stock	329	389	473	445	416	388	354	320	286
Bank of Papua New Guinea special loans	18	—	—	—	—	—	—	—	—
Treasury bills	60	167	352	592	1,008	1,218	1,615	1,932	2,187
External debt by source	1,064	1,011	1,121	1,282	1,537	1,718	1,811	2,166	2,705
International agencies	814	823	918	1,011	1,279	1,476	1,579	1,997	2,568
Commercial loans	228	168	188	259	243	228	220	157	124
Other loans	22	20	15	12	16	15	13	12	13
Total debt	1,470	1,567	1,945	2,319	2,961	3,324	3,781	4,418	5,178
As a proportion of GDP (%)									
Domestic debt	13	15	20	21	26	25	28	33	32
External debt	35	28	27	26	28	27	26	32	35
Total debt	48	43	47	47	54	52	54	65	67

Source: The Australian Agency for International Development, *The Economy of Papua New Guinea: 1999 Report*, p. 125.

Meanwhile external funds, practically the only way out of this situation, became scarce. In the spring of 1999, the last months of the previous regime, the government was in serious financial difficulty and unable to secure new funds. Among the reasons for the change in government was Port Moresby's inability to manage these crises and deliver to the provinces the funds they were promised.

The challenge for the new government has been to free the central bank from sustaining the government and direct it to restoring price and exchange rate stability. Restoration of credibility to the PNG government and its central bank has taken not only passing a central banking act and promising other structural reforms but also a specific provision in the Central Banking Act of 2000 to limit the central bank's credit

to the government to an operating overdraft of K100 million. With the passage of the act and the submission of a more realistic budget, the new government obtained urgent financial aid from overseas which led to improvements in both the central bank's focus on monetary policy and some stability in inflation and exchange rates.

In 1999 as a whole, inflation averaged 14.0 percent. In the quarter ending in December 1999, the annualized rate of price inflation was down only slightly to 13.2 percent. In first-quarter 2000, however, the annualized rate was up to 19.6 percent. In the quarter ending June 2000, inflation was down to 15.0 percent and was expected to be down to 12.9 percent for 2000 as a whole. These fluctuations show that the longer-term impacts of government's efforts to stabilize

PRICES OF MAJOR EXPORTS

	Unit	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Gold	US\$/oz, cif	383	362	344	360	384	384	388	332	295	298	305	314
Copper	US\$/lb, cif	120	106	104	107	161	132	103	104	76	96	81	84
Oil	US\$/bbl	21	17	18	18	16	18	21	21	14	14	15	15
Coffee	K/ton, fob	1,632	1,706	1,285	1,479	3,165	3,893	3,055	5,505	5,705	5,521	5,526	4,600
Cocoa	K/ton, fob	882	950	882	859	1,115	1,559	1,615	1,899	3,135	3,336	3,400	2,837
Copra	K/ton, fob	157	118	247	251	292	427	494	523	668	808	710	624
Copra Oil	K/ton, fob	333	386	625	441	620	897	1,036	1,051	1,310	1,562	1,626	1,631
Palm Oil	K/ton, fob	229	263	286	315	336	762	683	753	1,277	1,170	977	874
Rubber	K/ton, fob	643	647	773	853	1,377	1,482	1,464	1,477	1,490	2,497	2,559	3,049
Logs	K/m3, fob	66	76	87	169	164	174	178	172	145	156	189	189

Source: The Australian Agency for International Development, *The Economy of Papua New Guinea: 1999 Report*, p. 130.

inflation and, more important, the exchange rate, have yet to be felt. It will be 18-24 months before the final verdict on central bank and monetary stability can be reached.

The impact of poor fiscal discipline, unpredictable monetary policy and an unstable exchange rate can also be seen in an unstable balance of payments (BOP) account of the 1990s. BOP surpluses of the mid-decade turned into deficits in 1997-98, mainly because of adverse economic conditions. As the economy improved in 1999-2000, BOP balance once again showed surpluses. The closer the overall BOP balance is to zero, the better. However, since the various components of the BOP often move in opposite directions, they can produce conflicting results depending on particular conditions.

Weakness in the trade balance caused most of the decline in the BOP balance in 1997-98 because of low commodity prices and lower export volumes. The services balance, affected by the salaries of expatriate labor against which PNG has no large services sales (e.g. tourist receipts), remained relatively unchanged because the cost of expatriate labor, most of which is white-collar, does not necessarily change with cyclical changes. As commodity prices and export quantities increased in 1999-2000, mainly because of favorable climatic conditions, the trade balance improved significantly, contributing to the overall move of the BOP balance from deficit to surplus.

A BOP account of particular meaning in PNG is the capital account since the country imports most of its capital. A surplus in the capital account can be an indicator of investor confidence in PNG while repayment of loans, on the other hand, may indicate transfers out of PNG. In 1998-99, for example, the capital account showed large deficits that, according to the Bank of PNG, turned into a surplus in the first-half of 2000. The start of preliminary design and engineering work on the proposed gas pipeline in early 2001, for example, would boost the capital account as most of it would be financed with foreign capital.

Another element contributing to financial health in PNG and the restoration of confidence in the market is the new government's plan to reduce public debt. Total public debt dropped from a record 65.8 percent of GDP in 1998 to 63.0 percent in 1999 and, based on the first half, to 46.4 percent in 2000. This is the lowest ratio in seven years and considered low for a developing economy. Only time will tell whether the new government can adhere to debt reduction and fiscal discipline as donors demand.

II.7 Forecast

II.7.1 Economic and Financial Outlook

There are no formal and publicly available macroeconomic forecasts of PNG by the private sector. Most major banks obtain their PNG forecasts from consultants in Australia. PNG government agencies generate their own forecasts and their methodologies and sources of data are often unavailable. Practically, the only

forecasts in the public record are those prepared for budget submittals to Parliament. Since government forecasts, especially those accompanying budget proposals, have a tendency to be optimistic, they should be taken as directions rather than magnitudes.

PNG's new government issued its first financial and economic forecast in late 1999 for the 2000 budget. It was to be revised in late 2000 for the 2001 budget. According to the 1999 forecast, real GDP was to grow 4.7 percent in 2000, 5.9 percent in 2001 and around 5.0 percent in 2002-2003. Inflation was to drop to 12.9 percent in 2000, 4.1 percent in 2001 and around 5.0 percent in 2002-2003.¹²

These forecasts were based on the assumptions that oil exports would remain in line with 1997-99 quantities (about 30 million barrels a year), the price of crude oil would be \$19 and log prices would improve somewhat during the forecast years. Gains were also expected in agricultural commodity prices and quantities. The forecast parameters for domestic production and prices were within reasonable ranges.

Less certain were forecasts of the exchanges rate, that is, the Kina at \$0.38 in 2000 and \$0.40 in 2001 and the average 6-month T-bill rate down to 15.0 percent in 2000 and 10.0 percent in 2001. (In September 2000 the Kina was \$0.3330, and in June 2000 the T-bill rate was 16.1 percent.)

The other main assumption for budget purposes was finalization of IMF and World Bank aid in 2000 and disbursement of most of it in 2001. Now it appears that most of the funds will be disbursed in 2001-2002, depending on the progress PNG makes adopting the reforms on which the receipt of aid depends. Forecasts based on the aid package being in place in 2001 may need to be moved forward by a year since the \$24-million installment of the IMF loan released in October was behind schedule.

These releases will stabilize the government's cash flow and its international reserves, which now cover only 1.9 months of imports. The extended timetable should be viewed favorably by markets. With the stabilization funds in place in 2001-2002, the task of urgent financial and economic rehabilitation of PNG will have been completed.

With a stable financial regime in place, it is expected that private investors will be reassured of PNG's commercial viability, for which a major test is the work beginning on the gas pipeline in 2001. (Chevron Niugini Ltd. has indicated that a \$75 million engineering and design project in its final stages of preparation would start in early 2001.) In fact, the gas pipeline is now seen as the litmus test for large capital-intensive projects in PNG.

The pipeline project, with an estimated total cost of \$3.5 billion, will not only revitalize the economy, it will pave the way for the nickel mine to attract the capital it needs. Until the gas pipeline and the nickel mine get started, there may be no other large projects in PNG in the

¹²Informal discussions with the central bank in Port Moresby in mid-October 2000 suggested little change in the government's forecasts for 2001-2003.

near future. Even Australian investors who have been active in PNG for decades speak with caution about large projects.

The reason for caution is PNG's recent record. Political and financial volatility has eroded confidence in PNG. The government knows this and has promised to do what is necessary to stabilize PNG's financial outlook and reassure investors. The effort to settle the Bougainville issue is in order to remove Bougainville from the agenda. With Bougainville aside, even if that entails granting more autonomy than it had at one time intended, the government can point to political stability, now the basis of financial stability and economic growth not only in PNG but globally. With restoration of political and financial stability, PNG can grow more rapidly than government's forecasts suggest.

An important development in November 2000 that would contribute to financial stability was the passage of the 2001 budget by unanimous vote of Parliament. Building on the progress made in 2000, the 2001 budget reduces government deficit and shifts more spending to essential areas such as public health, education, law and order, primary industry and infrastructure. As the 2000 budget, the 2001 budget was based on the key assumption that the economy would continue to grow in 2001-2003, with real GDP growth rate accelerating in 2002-2003.

The World Bank, the IMF, Australia and other donors have been watching the developments in Port Moresby since the new government took office. To the degree that their public announcements reflect their views of the development in PNG, they have all been encouraging.

II.7.2 Political Outlook

The near-term political outlook improved significantly with the passage of the Political Parties and Candidates Integrity Bill in November last year. Passed by a unanimous vote along with the 2001 budget, this bill is intended to bring stability and coherence to the political process through a formal legal framework. This is an important step toward establishing legally competent institutions in PNG. It mandates the registration of political parties, limits outside funding for political activities and restricts the voting powers of independent Members of Parliament (MPs) who have sometimes voted to destabilize coalitions, even topple prime ministers.

This voting pattern of independent MPs has, in part, been the reason why no prime minister of PNG has ever served a full five-year term. With forcing independent MPs to join parties and coalitions, the expectation is that the political process will become stable and predictable which, in turn, would allow political leaders to focus on governance and managing the nation's natural, economic and financial resources more efficiently.

The Prime Minister's coalition enjoys a solid majority, 103 of the 109 seats, in Parliament. Still, to avoid the possibility of a no-confidence vote and other disruption

to the political scene in Port Moresby after the first 18 months in office, the Prime Minister adjourned Parliament in November until July 2001.¹³ When the Parliament reconvenes in July, it will have a year before the next elections in June or July 2002. Whoever comes to power after the next elections, the expectation is that the political process will have stabilized so the next government will continue to build on the progress PNG will have made in the next 18 months.

III. THE CHALLENGES AHEAD

In a paper at the Papua New Guinea Update on October 17, 2000, an Australian National University's National Center for Development Studies scholar made the following observations: (1) since independence, poverty and wealth disparity had increased, economic and social development had declined and a slow disintegration of civil society was in progress; (2) by 1998, per capita GDP was just 0.8 percent higher than at independence and non-mining GDP per capita was down 15.3 percent; (3) "with mineral revenues accruing mostly to an elite beneficiary group, conditions for the bulk of the population have taken giant strides backwards."

The main reason for this report card was "that no government has yet been able to properly grapple with the fundamental constraints to economic and social development." The most important of the constraints was a lack of sound legal institutions.¹⁴

Whether or not these and other claims of economic regress, rather than progress, can be empirically and objectively verified, there is one basic issue that all development economists agree on and that is the need for an institutional structure within which a modern economy can function. In this respect, the Asian financial crisis offers some useful lessons. The crisis showed that (a) when markets get ahead of underlying social (legal) institutions, markets and institutions both get in trouble, (b) the world has become a global village where decisions made in one place have an immediate impact in other places, no matter what the distance. Now that Asia is getting back on track, it will contribute to prosperity in the Pacific.

Markets reflect social, political and economic institutions as much as they reflect the market signals of price and cost. Investing in PNG is investing in the institutions that make up the social, political and economic structure of PNG as an economy, a market and a people. Generally these institutions are of two types: those arising from customs, traditions and habits, and those arising from secular principles by which people agree to live together

¹³A new government cannot be subjected to a no-confidence vote in the first 18 months.

¹⁴Theodore Levantis, *Tax Reform in Papua New Guinea*, October 17, 2000.

and conduct their business.

In the Pacific, the notion of constitutional liberalism, that is, respect for individual liberty within the rule of law, is a rather new phenomenon. Most Pacific economies operate under customary institutions. Doing business within customary institutions carries the risk that personalities, rather than principles, will shape outcomes. Thus the legally binding contract of the business transaction involves both more and less than meeting technical and financial criteria as determined by market rules. This is the basic difference between traditional and modern Western business practices.

Modern economic theory holds values, or beliefs, constant. It further postulates that no matter what one's private beliefs, more of an economic good is better than less, and that market agents engage in transactions based on both self-interest and mutual gain. The practical benefit of this system is that people of different beliefs can trade with each other as long as there are mutually beneficial gains and agreed-upon rules of conduct.

However, since economic rules essentially have a social basis, they can be manipulated. To minimize the potential risk of manipulation is to have written and enforceable laws governing economic and financial transactions. In most Pacific markets, the underlying institutions that support open and fair markets are being developed.

The Pacific islands in general and PNG in particular can build their institutional foundations so that people everywhere have faith in the market, but the rules must be clear and enforceable. The conditions the IMF has imposed on aid recipients include some of the reforms that constitute the foundations for the institutional rebuilding the Pacific needs to rejoin global markets.

The world's move toward becoming an even more integrated global village is irreversible. The question is whether the various markets, in reality the various peoples, can move toward some universal rules of market conduct.

The answer must be a definitive "yes," because the alternative is chaos and economic decline in the face of growing populations. As we work to develop a new universal economic theory for the global village, even closer links between the Pacific region and other markets must be forged. One way to do that is to help build more institutions led by commonly agreed-upon principles. Once the rules become relatively uniform in all markets, they will award success and failure with an even hand. As constitutional liberalism and open markets find acceptance in the Pacific, the Pacific economies will participate in the more harmonious market the global village needs in order to function.

Achieving a settlement in Bougainville is one of the most important steps PNG can take toward establishing a national economic development strategy. It is clear from the economic, financial and business experience of the last decade that government, business, labor and the traditional leaders need to come together and form a consensus on an economic development and change strategy that will make PNG a much more viable market now and in the long term. The economy will most likely grow haphazardly until a more unified national development strategy is in place.

Meanwhile, the pressure is on for the economy's productive capacity to grow, especially in rural areas. Directing productive capacity growth toward rural areas applies not only to agriculture but to tourism where the country has vast potential. PNG receives fewer than 70,000 visitors a year, of whom only 20,000 are typical leisure and business tourists. Many coastal areas around the country have the potential to promote eco-tourism, adventure tourism and other specialty tourist markets. With a more unified economic development and change strategy, the PNG economy can easily grow 10-plus percent a year. It will take such a rate of growth to make a difference in the livelihood of the majority of the population of Papua New Guinea.



PACIFIC ISLANDS FACT SHEET

US DOLLAR-DENOMINATED ECONOMIES

	Population	Land Area (square miles)	Notable Geographic Characteristics	Capital/ Distance from (miles)	Currency	Major Languages
GUAM	163,373	212	One island. Major US naval base and regional trans-shipment center at Apra Harbor. In hurricane path.	Agana/ Honolulu 3,800 Tokyo 1,600	US dollar	English, Chamorro, also Tagalog, Japanese
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS (CNMI)	79,429	177	Saipan the largest island, Tinian and Rota next, 14 others in the chain. 125 miles north of Guam. US territory closest to Asia.	Garapan, Saipan/ Honolulu 3,700 Tokyo 1,500	US dollar	English, Chamorro, Carolinian
FEDERATED STATES OF MICRONESIA (FSM)	116,268	270	607 islands and atolls, Pohnpei 130 square miles, other major islands Kosrae, Yap and Chuuk. The 4 FSM states span 1,700 miles from east to west.	Kolonia, Pohnpei/ Honolulu 3,100 Hong Kong 3,100	US dollar	English, 8 major local languages
REPUBLIC OF PALAU	18,500	170	343 islands, the main group encircled by a hundred mile reef. Babeldaob 136 square miles. 8 other inhabited islands. Rock Islands.	Koror/ Honolulu 4,600 Tokyo 2,000 Hong Kong 1,700	US dollar	English, Palauan, Sonsorolese- Tobian
REPUBLIC OF THE MARSHALL ISLANDS (RMI)	50,840	70	34 coral islands, 870 reefs, highest elevation 33 feet above sea level, average elevation 7 feet.	Majuro/ Honolulu 2,300 Guam 1,800	US dollar	English, Marshallese dialects
AMERICAN SAMOA	58,900	76	5 islands, 2 atolls. Pago Pago Harbor. Home of newest US national park. In hurricane path.	Pago Pago, Tutuila/ Honolulu 2,600 Los Angeles 4,800	US dollar	English, Samoan
TOTAL/AVERAGE	487,310	975				

NON-DOLLAR ECONOMIES

FRENCH POLYNESIA	231,500	1,609	130 islands, mostly atolls in 5 archipelagoes. Tahiti the largest island, 400 miles square, maximum elevation 7,464 feet.	Papeete, Tahiti/ Honolulu 2,800 Los Angeles 4,100 Paris 10,400 Tokyo 5,900	French Pacific franc (F CFP)	French, Tahitian
NEW CALEDONIA	209,222	7,376	Main island, Grande Terre 250 miles by 30 miles (larger than the Hawaiian Islands together), mostly mountainous. Several small islands.	Noumea/ Honolulu 3,900 Paris 10,400 Brisbane 900	French Pacific franc	French, 30 Kanak dialects
WALLIS AND FUTUNA	14,800	106	2 main islands, highest elevation 2,493 feet.	Wallis Island/ Honolulu 2,700 Paris 10,000	French Pacific franc	French, East Uvean, East Futunan
PAPUA NEW GUINEA (PNG)	4,800,000	178,704	Eastern half of the island of New Guinea. Largest by far Pacific island-state land mass. Other main islands New Ireland, New Britain and Bougainville.	Port Moresby/ Honolulu 4,300 Cape York, Australia 300 Tokyo 3,100 Hong Kong 3,100	Kina	English, Tok Pigin, Hiri Motu, hundreds of vernaculars
COOK ISLANDS	19,600	92	15 widely dispersed islands including volcanic peaks and atolls. Rarotonga the largest island 26 miles square. In hurricane path.	Rarotonga/ Honolulu 3,000 Wellington 2,000	New Zealand dollar	English, Cook Islands Maori
SAMOA	168,000	1,158	4 inhabited islands, 5 uninhabited. Highest point 6,100 feet, Mt. Silisili on Savai'i. In hurricane path.	Apia/ Honolulu 2,600 Suva 700 Brisbane 2,500	Tala	English, Samoan

GDP/GNP (US\$ million current)	Per Capita GDP/GNP (US\$)	Major Income Sources	Political Status	Major Sources of External Investment	Major Sources of Future Income
3,065.8	18,766	Tourism, military, trade and services	US territory since 1898. Guam Organic Act of 1950 conferred U.S. citizenship. Some push for commonwealth status.	US, Japan, Korea	Tourism, services
664.6	8,367	Tourism, garment manufacturing, trade and services	After WWI under Japanese mandate. In 1947 became part of US Trust Territory of the Pacific. Since 1978 a Commonwealth of the US. Islanders are US citizens.	Japan, Korea, Hong Kong, US	Tourism, services
230.0	1,978	US payments, government services, fisheries, tourism	After WWI under Japanese mandate. In 1947 became part of a UN Trust Territory. Became sovereign in 1979. In compact of free association with US as of 1986.	US, Japan	Compact status being renegotiated. Fisheries development, tourism
129.3	6,989	US Compact payments, tourism	After WWI under Japanese mandate. In 1947 became part of US Trust Territory. Became sovereign in 1994, in compact of free association as of 1994. Compact ends 2044.	Japan, US	Compact money, tourism
102.1	2,009	US payments, Kwajalein Missile Range, government services, copra, fisheries	After WWI under Japanese mandate. In 1947 became part of a UN Trust Territory. Became sovereign in 1979. In compact of free association since 1986.	US, Japan	US military. Compact being renegotiated. Fisheries.
253.0	4,295	Tuna canneries, government services, remittances from Samoans overseas	US territory since 1899. Samoans are US nationals.	US	Canneries, remittances, US entitlements
4,444.8	9,121				
3,929.2	16,973	Payments from Metropolitan France, tourism, Tahitian pearls	French controlled from the 19th century. Overseas territory of France since 1957. Active independence movement.	Metropolitan France	French transfers, tourism, pearls
3,058.0	14,616	Payments from Metropolitan France, nickel, agriculture and ranching, tourism, aquaculture	1853 became a French possession. Overseas territory of France since 1946.	Metropolitan France	French transfers, nickel, tourism, agriculture, aquaculture
28.7	1,939	French transfer payments, trochus shells	French controlled from the 19th century. Overseas territory of France since 1961.	Metropolitan France	French transfers
3,754.4	782	Minerals, oil and gas, forestry, agriculture, tourism	Under Australian & German control before WWI. Administered by Australia after WWII. Independent within the British Commonwealth since 1975. The Bougainville secessionist movement ended by a formal treaty in April 1998.	Australia, UK	Minerals, oil, timber, fisheries, tourism
76.1	3,882	Government aid, services, tourism	Self-governing since 1965 in association with New Zealand. Cook Islanders are citizens of both Cook Islands and New Zealand.	New Zealand	Tourism
199.0	1,185	Agriculture, remittances from abroad, tourism, manufacturing	Under German control before WWI, New Zealand after. New Zealand trusteeship after WWII. Independent since 1962.	New Zealand, Japan	Agriculture, tourism, light manufacturing

PACIFIC ISLANDS FACT SHEET *(continued)*

	Population	Land Area (square miles)	Notable Geographic Characteristics	Capital/ Distance from (miles)	Currency	Major Languages
FIJI	812,300	7,055	320 islands. Viti Levu 4,000 miles square, Vanua Levu 2,100 miles square. Major islands are mountainous and forested to windward.	Suva/ Honolulu 3,100 Sydney 2,000 Tokyo 4,500	Fiji dollar	English, Fijian, Hindi
KIRIBATI	83,976	266	33 islands scattered 2,400 miles east to west, 1,300 miles north to south. Almost entirely low-lying atolls, Christmas Island the largest.	Tarawa/ Honolulu 1,300 Tokyo 3,900	Australian dollar	English, Micronesian
SOLOMON ISLANDS	393,000	11,197	850 mile long double island chain. 6 mountainous main islands, Guadalcanal 2,080 miles square.	Honiara, Guadalcanal/ Honolulu 3,960 Port Moresby 900	Solomon Island dollar	English, Solomon Islands Pijin, more than 80 vernaculars
TONGA	97,800	386	Main islands volcanic, some 150 coral atolls, 36 permanently inhabited.	Nukualofa/ Honolulu 3,100 Brisbane 2,000	Pa'anga	Tongan
VANUATU	199,016	4,707	80 scattered islands, several active volcanoes. Largest island Espiritu Santo 1,500 miles square, highest point 6,158 feet.	Port Vila, Efate/ Honolulu 3,500 Tokyo 4,100	Vatu	French, English, Bislama
NAURU	11,200	8	A single island with a 100 foot high central plateau of now nearly exhausted phosphate-bearing rock.	Nauru/ Honolulu 2,800 Banaba, Kiribati 200	Australian dollar	English, Nauruan
NIUE	1,745	101	Coral island rising 65 feet from the ocean and another 130 feet to a central plateau.	Alofi/ Wellington 1,800 Suva 800	New Zealand dollar	English, Niuean
TOKELAU	1,507	4	3 atolls with islets 10 to 16 feet above sea level. In hurricane path.	Nukunonu/ Honolulu 2,300 Wellington 3,800	New Zealand dollar	English, Tokelauan
TUVALU	10,900	10	5 atolls, 4 coral islands, maximum elevation 16 feet above sea level.	Funafuti/ Suva 700 Sydney 2,500	Australian dollar	English, Tuvaluan
TOTAL/AVERAGE	7,054,566	212,779				
GRAND TOTAL/ AVERAGE	7,541,876	213,754				
HAWAII	1,205,126	6,423	4 main islands. Island of Hawaii 4,028 miles square, highest point of Mauna Kea 13,796 feet. Mauna Loa and Kilauea on Hawaii both active volcanoes. Maui 727 miles square, Oahu 597 (Waikiki), Kauai 552. In hurricane path.	Honolulu/ San Francisco 2,400 Los Angeles 2,600 Washington 4,800 Tokyo 2,500	US dollar	English

SOURCES: Europa, *The Far East and Australasia*, 2000; Gary L. Fitzpatrick and Marilyn J. Medlin, *Direct-line Distances, International Edition*, New Jersey, 1986; International Monetary Fund, *International Financial Statistics*, November 2000; David Stanley, *Micronesia Handbook*, Chico, California, 1989; David Stanley, *South Pacific Handbook*, 5th Edition, Chico, California, 1993; State of Hawaii Department of Business and Economic Development, *Data Book 1999*, Honolulu, 1999;

GDP/GNP (US\$ million current)	Per Capita GDP/GNP (US\$)	Major Income Sources	Political Status	Major Sources of External Investment	Major Sources of Future Income
1,821.3	2,242	Sugar and other agriculture, tourism, forestry, fishing, mining, garment industry	Annexed by Great Britain in 1874. Became independent within the Commonwealth in 1970, rejoined the Commonwealth in 1997.	Australia, New Zealand, EU, Japan	Agriculture, tourism, mining, light manufacturing
76.0	905	Agriculture (copra), remittances, aid	Annexed by Britain in 1919. A republic within the British Commonwealth since 1979.	NA	Fisheries development
343.7	875	Agriculture, timber sales, fishing and fish canneries, aid	British protectorate as of 1873. Politically independent within the Commonwealth since 1978.	Australia, Japan	Agriculture, fisheries, tourism
177.0	1,810	Agriculture, tourism	British protectorate as of 1900. Independent monarchy within the Commonwealth.	NA	Tourism, agriculture
224.6	1,129	Agriculture and ranching, tourism, Offshore Finance Center, services	Anglo-French New Hebrides Condominium in 1906. Republic of Vanuatu within the British Commonwealth established in 1980.	Australia, Japan	Tourism, agriculture
368.0	32,857	Phosphates and investments from phosphates	From 1919 administered by Australia. Became an independent republic in 1968.	NA	Investments from phosphate
6.1	3,476	Subsistence activity, government aid	Self-governing since 1974 in free association with New Zealand.	NA	Tourism
1.2	796	Subsistence activity, government aid	Non-self-governing territory administered by New Zealand beginning 1925.	NA	Subsistence activities, government aid
9.0	826	Subsistence activity, government aid	Independent state within British Commonwealth since 1978.	NA	Subsistence activities, government aid
14,072.3	1,995				
18,517.0	2,455				
35,146.4	29,164	Tourism, services, trade, government	Annexed in 1898, became a US territory in 1900, became a state in 1959.	US, Japan, Australia	Tourism, defense, services, trade, government

Peter W. Thomson, *Trade and Investment in the South Pacific Islands*, Honolulu, 1989; World Bank, *World Development Report*, 2000-2001; various Bank of Hawaii economic reports, 1992-2000, and other sources. (Rev. 1/01)

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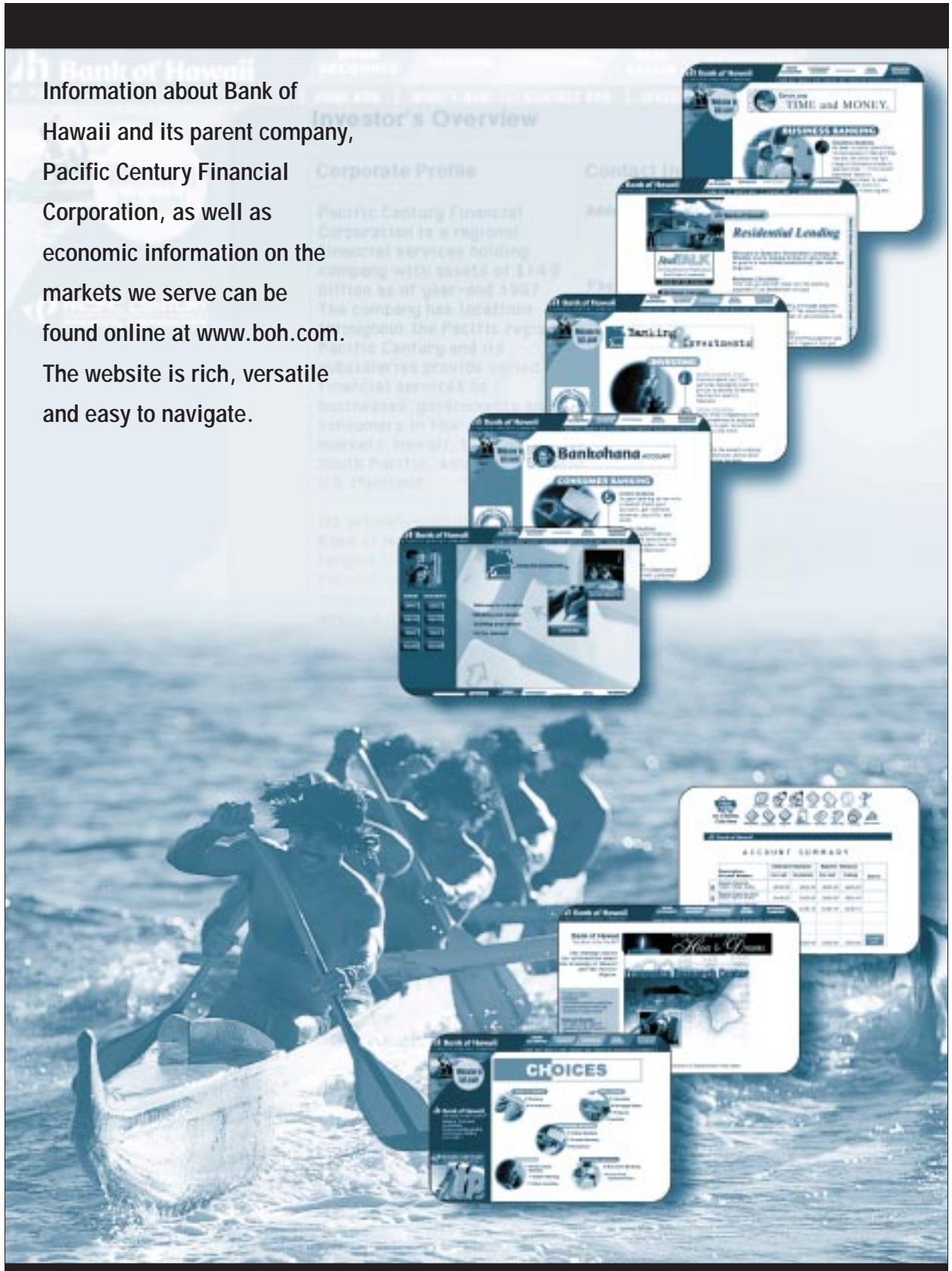
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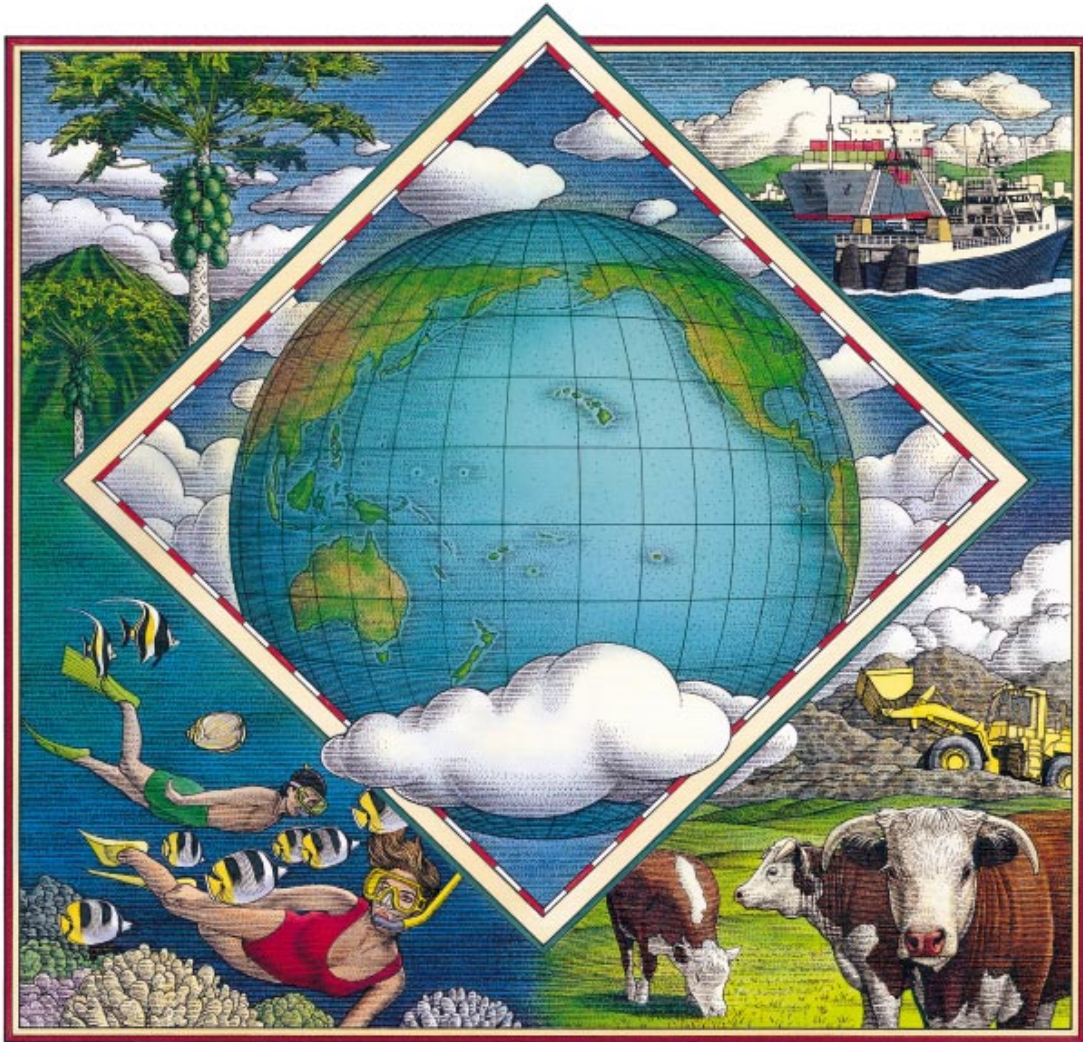
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