The Business and Investment Environment in Papua New Guinea in 2007: Private Sector Perspective

A Private Sector Survey

REPORT

INSTITUTE OF NATIONAL AFFAIRS
Discussion Paper No. 93
July 2008
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>ANU</td>
<td>Australian National University</td>
</tr>
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<td>BSP</td>
<td>Bank South Pacific Limited</td>
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<td>CCAC</td>
<td>Community Coalition against Corruption</td>
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<tr>
<td>CIMC</td>
<td>Consultative Implementation &amp; Monitoring Council</td>
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<tr>
<td>ICAC</td>
<td>Independent Commission against Corruption</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>INA</td>
<td>Institute of National Affairs</td>
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<td>IPA</td>
<td>Investment Promotion Authority</td>
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<td>IRC</td>
<td>Internal Revenue Commission</td>
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<td>MTDS</td>
<td>Medium Term Development Strategy</td>
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<td>NEFC</td>
<td>National Economic and Fiscal Commission</td>
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<td>NSO</td>
<td>National Statistical Office</td>
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<td>NLDT</td>
<td>National Land Development Taskforce</td>
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<tr>
<td>OLIPPAC</td>
<td>Organic Law on the Integrity of Political Parties and Candidates</td>
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<td>PICs</td>
<td>Pacific Island Countries</td>
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<td>PPP</td>
<td>Public Private Partnership</td>
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<td>SMEs</td>
<td>Small and medium enterprises</td>
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<td>SOEs</td>
<td>State-owned enterprises</td>
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<td>TIPNG</td>
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PREFACE

The 2007 Private Sector Survey was undertaken to gain a better understanding of the constraints that hinder the development of business in Papua New Guinea, as perceived by the real drivers of growth and employment generation, namely the private sector itself. Businesses for the purposes of this survey include sole traders, partnerships, cooperatives, business groups and public companies, but also embrace the State-owned enterprises (SOEs), which in PNG are still providing many critical service and utility functions, albeit often operating under monopoly or semi-protected arrangements. These SOEs, whilst often protected from some of the vagaries of the market, nevertheless share many of the challenges and constraints faced by private enterprises in PNG’s business environment.

Businesses operating in PNG range in size from small, medium to large, are foreign or locally-owned enterprises, distributed across urban and rural areas, and can be either specialist or diversified. PNG also has a major informal economy, providing food and livelihoods for a majority of the population, many operating as family-based, largely micro businesses. This survey, however, is focused fundamentally upon formal sector businesses, and their perception of their own needs and the constraints they confront. Nonetheless, the importance of the informal economy is recognised in terms of its major contribution to overall GDP and particularly in providing widespread income and employment opportunities for the majority of Papua New Guineans. The informal economy also shares many, though not all, of the same operating constraints as the formal sector. There are also many natural links between the formal and informal economies, such as village-based out-growers linked to agro-nucleus enterprises, wherein the formal enterprises are complemented by suppliers or distributors from the informal economy; such as out-growers in oil palm, poultry, fish or spices, or the distribution, for example of mobile phone top-up cards.

A separate survey of the Informal Economy has also been conducted in 2007, funded by the IFC, with active assistance from INA staff and the CIMC Informal Sector committee. Entry into the formal sector is a possibility for some informal sector participants, but costs and impediments to entry (including bureaucratic processes, as well as tax responsibilities) are widely perceived as exceeding potential benefits. Reducing the constraints and improving opportunities for legitimate business - including encouraging new entrants into the formal sector - and encouraging diversification and fair competition, would contribute to more sustainable economic development, employment generation and the increased availability of more affordable goods and services. But this entails government playing its part, in performing its core functions (including provision of infrastructure, law and order and basic education and health services) more reliably and accountably.

There are many larger locally-owned and even foreign-owned enterprises in PNG which have not registered and entered the formal sector. Whilst the informal economy provides a valuable cushion (sometimes for an interim period) for failed enterprises and entrepreneurs, viable larger enterprises (and foreign-owned enterprises) have no
legitimate right to ‘freeload’ on public services and avoid their responsibilities. However, the social contract to tax-payers and the wider public, requires that public money is utilised effectively to meet public needs, including the legitimate requirements of the private sector. When the State fulfils this mandate, it is easier to encourage businesses to honour their corporate responsibilities, and to encourage larger informal enterprises to formalise their operations.

The INA conducted two similar private sector surveys in 1999 and 2002 respectively. The 2007 survey was conducted to update and make the Government and wider public aware of the private sector’s current perception of Papua New Guinea’s business environment, particularly in the light of significantly changed economic conditions since 2002. In all, 243 questionnaires were completed and returned. For the two earlier surveys, businesses were categorised into eight broad economic industry groups: (i) manufacturing and mining; (ii) building and construction; (iii) transport and communication; (iv) hotels, restaurants and bars; (v) retail and wholesale; (vi) finance and investment; (vii) other services (mainly businesses and recreational services); and (viii) agriculture, forestry and fisheries. In the 2007 survey, two additional categories were included to give a total of ten economic industry groups. The two additional categories are: (i) utilities and (ii) manufacturing, which has been separated from mining and quarrying. The “other” category in this survey mainly covers activities such as gaming and pokies, hair salons and sporting enterprises.

The survey identifies the key impediments identified by the business sector to be restraining private sector development in PNG. In doing so, the survey contributes to an improved understanding of what needs to be addressed to improve PNG’s business and investment environment. The survey findings can therefore assist government in developing comprehensive policy interventions for improved economic performance, with a particular focus on investment, small and medium sized enterprises, transport, law and order, education and training.

Overall it is hoped the key findings and policy issues highlighted in this Report (first made public in an INA-hosted workshop in Port Moresby in December 2007) will assist the Government, private and non-government organisations, and donor organisations, in identifying the most appropriate policies and programmes to support the development of a growing and competitive private sector in PNG; a private sector best able to contribute to the nation’s sustainable development.

Paul Barker
Director,
Institute of National Affairs
January 2008
AKNOWLEDGEMENTS

The Institute of National Affairs (INA) wishes to thank the Asian Development Bank (ADB) for providing funding and other support, for the 2007 Business Survey and the workshop held in December 2007. We thank Solomon Awili of the University of Papua New Guinea’s School of Business Management for overseeing the survey, undertaking initial data analysis and write up, Robert Harden for his considerable editing input, Dr Paul Holden for his contribution to the Executive Summary and Dr Theo Levantis, who co-authored the 2002 survey, for his valuable technical advice and encouragement in the preparation of the 2007 survey.

The Institute is also particularly appreciative of those businesses, agencies, chambers and individuals, largely in PNG, but some based abroad, who devoted valuable time from their busy schedules to participate in this nation-wide business survey. Being asked to fill in detailed surveys can be a demanding and often apparently pointless exercise, but we certainly hope that this survey will provide valuable information and contribute to an improved business and investment environment in PNG for the future. The National Statistical Office (NSO) also assisted with the business census data, which we greatly appreciate, and the survey benefited from useful discussions with staff of the Bank of Papua New Guinea.

Without the aforementioned parties’ invaluable partnership and support, we would not have been able to gain a full appreciation of the challenges the business sector continues to face, the opportunities available and the strategies that can be employed to assist in charting a better way forward to enhance the growth of a dynamic private sector.

Finally, we would like to acknowledge the considerable effort of the staff of the Institute of National Affairs who undertook this survey, diligently circulating and following up questionnaires, inputting data and contributing to the survey design and analysis. In particular, we wish to thank Kenson Kiopa, who was ably supported by Stephen Goie and the late Janine Matawan and provincial field assistants nationwide.

Disclaimer: The Institute of National Affairs (INA) has commissioned this survey. The views expressed in the report are based primarily on the findings of the survey supported by authoritative sources but do not necessarily reflect the views of the Institute.
EXECUTIVE SUMMARY AND KEY FINDINGS AND RECOMMENDATIONS

Introduction
This report describes the results of a 2007 survey of 243 businesses in Papua New Guinea. Businesses were asked to provide their views on a wide range of issues that affect the way that they do business, the factors that influence their investment decisions and the relationship between the business community, government and the public sector more generally. A similar survey was undertaken 5 years earlier, which provides a unique opportunity to compare how the business climate has evolved through time. The comparisons are especially interesting in the light of the political stability of the past 5 years and the resource boom that PNG has been experiencing recently. In addition, a Private Sector Assessment analysing the constraints to doing business in Papua New Guinea was recently completed - the survey results provide valuable additional details on PNG’s business environment that complement the PSA analysis and provide additional data against which to test its conclusions.

This summary highlights the main findings of the survey and should be read as a supplement not only to the full report but also in conjunction with the recently completed Asian Development Bank Private Sector Assessment.

Summary of the Findings
The survey identified a number of concerns that impact the cost of doing business and the propensity to invest. The most important are:

♦ There is still widespread concern regarding the possibility of political instability, even though the previous government (2002-2007) completed its full five-year term (thanks to a prior Organic Law amendment) and the current coalition government comprises many Members from that previous administration.

♦ Many businesses said that instability in laws, regulations, and rules adversely affected their businesses.

♦ Corruption was reported to be a widespread problem (the second most serious individual after crime) with a majority of businesses also saying that they had to make irregular payments in order to get things done.

♦ Most businesses claimed that government did not consult them before the promulgation of laws or regulations that affected business.

♦ There was widespread dissatisfaction with the quality of infrastructure and services provided by the public sector. Most businesses indicated that the quality of the services had declined since the previous survey had been taken.

♦ Law and order problems imposed substantial costs on businesses and many respondents indicated that this had adversely affected their decision to expand or invest.

♦ The most important constraints to doing business identified by respondents were law and order, political uncertainty, corruption, and the quality of infrastructure (including utilities and telecommunications services).

1 Asian Development Bank, 2008, Foundation for the Future: A Private Sector Assessment for Papua New Guinea
The Survey Sample
Every effort was made to ensure that the sample was representative. Of the businesses that participated in the survey slightly over half were PNG-owned, about a quarter were foreign-owned, and PNG citizens and foreigners jointly owned the balance. The sample consisted almost exclusively of formally registered businesses, 80% of which have been in business for at least 5 years. Nearly half of the businesses interviewed operated outside the main centres of Port Moresby and Lae. Forty five percent of these were classified as large businesses, having a turnover of more than K5 million and the other 55% were drawn from small and medium-sized enterprises. About 20% of the respondents were also exporters. An explicit effort was made to ensure that businesses surveyed included those from all parts country. The majority of respondents to the survey (80%) had been in business for more than 5 years.

The businesses surveyed were drawn from 10 broad economic industry groupings.

♦ Agriculture, forestry and fisheries;
♦ Building and construction;
♦ Finance, business and investment;
♦ Hotels, restaurants and bars;
♦ Manufacturing;
♦ Mining and quarrying;
♦ Retail and wholesale;
♦ Transportation and communication;
♦ Utilities;
♦ Other services (e.g. gaming, hairdressing etc).

Methodology and Themes Surveyed
The survey was conducted between May and June 2007. It consisted of 26 questions grouped into the following themes.

♦ The impact of political uncertainty on businesses
♦ The effect of government regulations and policies;
♦ Business - Government relationships;
♦ The effectiveness of government services;
♦ Business security;
♦ Constraints to business and investment.

The Impact of Political Uncertainty on Businesses
Business is inherently risky. Investors and entrepreneurs invest capital and time in attempting to take advantage of commercial opportunities. Even in the United States, however, large numbers of businesses fail. In one sense, this is good, because it weeds out the inefficient and encourages productivity. However, when business risk, which is already substantial, is increased by political risk, the impact on investment is negative - investors will demand higher returns and shorter payback periods in order
to reduce their exposure to uncertainty, which lowers potential growth. Furthermore, experience in many countries indicates that investors’ memories are long - when policy changes are introduced, they do not immediately rush to invest, rather adopting a wait and see approach in order to make sure that the changes are permanent. Recent political stability in PNG provided an opportunity to ascertain the extent to which businesses in the country behaved in a similar fashion to those elsewhere.

During the 1990s, businesses experienced substantial instability arising from frequent changes in government, a breakdown in macroeconomic discipline and erratic and frequent changes in policies towards the private sector. This began to change in 1999 when the newly-elected (Morauta) Government introduced far ranging reforms aimed at enhancing policy and political stability, including the Organic Law on the Integrity of Political Parties & Candidates (OLIPPAC) in 2000. Notwithstanding these efforts, a breakdown in fiscal discipline in 2001 and early 2002 contributed to a weakening of business confidence, which may have served to undermine the Morauta Government’s earlier achievements. However, economic conditions in Papua New Guinea have improved considerably since 2002 and the (Somare) Government (2002 to 2007) was the first in PNG’s history to complete a full five-year term. Moreover, following the 2007 elections, a coalition government with much the same composition has continued in office. This period of continuity of government provides an excellent opportunity to assess the effects of greater political stability over the past 6 years.
The extent to which political instability harms businesses in PNG is shown in Chart 1. Fully 87% of respondents indicated that they were negatively impacted by periods of political instability and uncertainty. In this, there was little change with respect to the 2002 sample - a very similar number of respondents indicated concern in the two surveys, which suggests that the effect of unchanged government has yet to produce a positive response in the business community. Maybe this reflects continued policy uncertainty, despite the introduction of several Medium Term Strategies (notably MTDS – 2005-2010). Furthermore, businesses were asked in the 2007 survey how concerned they were regarding the stability of the political environment. Fully 76 per cent indicated that they were either "extremely highly concerned" or "highly concerned" regarding future political stability. [Chart 2]

The Impact of Government Regulation and Policies

Chart 3: Concern for the Stability of Rules, Policies and Regulations
Stable policies, rules and regulations, and simplicity and certainty in their application, are fundamental prerequisites for a sound business and investment environment. Frequent changes in rules and regulations raises the costs of compliance, makes businesses vulnerable to predatory officials, and increases the costs of doing business generally. A number of questions were asked of the respondents in order to gauge the extent to which changes in rules, policies and regulations are a concern of the business community in PNG.

Overall, there was high level of apprehension not only with respect to future changes but also relating to concern that there would be retrospective changes to rules and regulations. The latter issue is of special concern to investors, because an investment decision is made on the basis of cost calculations of the existing pattern of rules and regulations - if these change and raise the costs of compliance, investments that might have previously been profitable become less so and could make the decision to invest the wrong one.

Chart 3 indicates a substantial concern regarding stability of policies and rules. On average, 52% of businesses were “very concerned” or ‘highly concerned” over regulatory and policy stability while only 2 per cent were unconcerned. Importantly, there has been no significant easing in the level of concern recorded in 2007 compared to 2002. Overall, businesses remain worried over the stability of the ‘rules of the game’ imposed by Government. In turn, this perception can be expected to impact negatively on PNG’s investment outlook, including by increasing the risk of doing business in the country.

The second closely related question asked of respondents was whether they “feared retrospective changes to rules and regulations”. This issue is also central to the credibility of the regulatory and policy environment faced by business and in turn, the degree of risk associated with new investments. If businesses are concerned over retrospective changes to rules and regulations, they may apply a high-risk premium to the financial assessment of new investment proposals and other operational matters. This risk premium could mean the difference between new investment going ahead or being abandoned.

Once again, the majority of businesses (52%) were either ‘very highly concerned’ or ‘highly concerned’ over the possibility of retrospective changes to rules and regulations [Chart 4]. Furthermore, there was only a marginal improvement in the level of concern over retrospective changes between the 2002 and 2007 surveys.
An additional question regarding how policies changed with changes in government explains much of the concern regarding political instability. Respondents were asked to indicate the extent to which they agreed with the proposition that rules and regulations changed as government changed [Chart 5]. A substantial majority indicated that they had experienced rule changes when governments changed.

Chart 5: Propensity for Rule Changes with Changes in Government.

In addition, when asked how burdensome were government regulations, a substantial majority indicated that compliance is a major problem from the perspective of costs, complexity and processing time [Chart 6].
When asked whether the cost of compliance with government regulations affected investment decisions and increased the cost of doing business a substantial majority of respondents answered in the affirmative. Furthermore, nearly half the respondents indicated that they had abandoned investment due to compliance difficulties [Chart 7]. When these answers are considered in conjunction with those regarding concerns for the stability of rules and regulations, it seems that the combination of political uncertainty and the cost of compliance with rules and regulations is having a marked negative effect on investment.

**Business - Government Relationships**

In well functioning business environments, business-government relationships are collaborative. Ideally, Governments consult with the business community before embarking on policies or regulations that impact the costs and performance of business. Similarly, businesses refrain from seeking special favours, while at the same time being open to government concerns.
In PNG, the relationship between the private sector and government is not strong.

**Chart 7: Percentage indicating that they had abandoned investments due to compliance difficulties.**

When asked to rank their overall working relationship with the government and bureaucracy, 39% of businesses responded that the government was highly or very highly unhelpful whilst another 30% indicated that the government was fairly unhelpful.

Furthermore, a substantial number of respondents indicated that they were impacted by official corruption [Chart 9]. Sixty seven percent of businesses interviewed

**Chart 8: Private Firms' Perceptions of the Helpfulness of Government**
indicated that they had been impacted by corruption, with 40 percent saying that they had either been very highly affected or highly affected.

In a follow-up question on the frequency of irregular payments to government officials, just under 40% of respondents indicated that these payments always occurred or frequently occurred [Chart 10]. By contrast, about 34% of respondents said that they seldom or never made such payments.

Chart 9: Percentage of Businesses affected by Corruption

Chart 10: Frequency with which Firms Made "Irregular Payments"
Another set of questions asked the sample respondents about the effectiveness of public sector services for their businesses. The quality of the business environment is also dependent on the effectiveness of supporting services and infrastructure, such as water, telecommunications, electricity, ports, roads and the court system. As in other countries these services are provided in Papua New Guinea by a mixture of public and private suppliers. The recent Private Sector Assessment for Papua New Guinea and other economic reports (notably from NEFC) have consistently found that
infrastructure and supporting services are widely underfunded, limited in their availability and are often of poor quality.

The businesses surveyed were all asked to rank the quality of various infrastructure and other services. Overall, roads and bridges were ranked the poorest followed by telecommunications and postal services, electricity, and water and sewage. Included in the services to be ranked were finance and banking, which are supplied primarily by the private sector [Chart 11].

The overall perception of the quality and effectiveness of government services is very low. Over 80% of the respondents ranked these services as a fairly poor or worse [Chart 11a].

Furthermore, businesses perceive little improvement since the 2002 Survey. On a scale of 1 to 6, with 1 being excellent and 6 being extremely poor, respondents from all sectors rated government service provision as being of low quality [Chart 11 b].

When questions were asked about individual services and sectors, [Chart 12], the rankings indicate a substantial level of dissatisfaction by virtually all those included in the questionnaire. While financial and banking services, which are supplied primarily by the private sector, received the best ranking, even here there is no room for complacency as these services still received a below average ranking. This survey was also undertaken before the impact of competition in telecommunications (with the entry Digicel) had been fully absorbed by the private sector. Anecdotal reports over the last 12 months suggests that there has been a quantum improvement not only in the quality of the privately supplied telecommunications services, but also in the quality of those services provided by PNG Telikom. This lesson, namely that competition is good for both the public and private sector is one that has far-reaching implications for government efforts to improve service delivery supplied by SOEs, which centres around efficiency improvements and using public-private partnerships.
to reduce costs. The effectiveness of both of these measures will be enhanced by ensuring that there is competition.

The private sector certainly supports the aim of improving these services - in the separate question, 70% of respondents agreed or strongly agreed that there was a need for major reform in the delivery and quality of government services.

One part of public services that is generally regarded as effective and efficient is the court system. Over 60% off the businesses surveyed indicated that they had confidence in the judiciary and in court decisions (although there is a concern over its lack of capacity and extended delays in handling cases).

### Business Security

A strong and effective legal system, contributing to a safe and secure society, is a key requirement for a well functioning private sector. A secure law and order environment is required to help ensure security over physical assets and indeed, the security of employees. Aside from the costs associated with theft, high crime levels will deter business and investment by increasing insurance premiums, increasing the cost of internally provided security (guards and security systems) and by increasing the costs associated with the employment of skilled labour from abroad (or increasingly of retaining skilled labour at home). High crime levels can also impact adversely on a business’s productivity, for example if employees are unwilling or unable to work night shifts. This comprises the vicious circle, wherein inadequate employment and income earning opportunities provides the main stimulant to crime, which in turn is the main deterrent for business and job creation. A strong and effective legal system, including effective enforcement and deterrent, is required to ensure that property rights and business contracts can be readily secured and effectively enforced. Without a degree of certainty in the legal enforceability of property rights, security over ownership of assets will be diminished and the incentive to accumulate wealth and invest in productive capacity will be eroded.

PNG’s poor law and order environment has attracted considerable attention and debate over the past two decades, both within PNG and abroad. It has regularly been cited as a major constraint to business activity and investment. The 2007 private sector survey provides an opportunity to assess whether the situation has improved in recent years, or whether it remains one of the most foremost constraints faced by businesses in PNG.

Participants in the survey were asked to indicate the extent to which law and order problems have affected their businesses. Fully 87% indicated that they were "fairly affected", "highly affected", or "very highly affected" by the law and order situation [Chart 13].
The costs of dealing with crime are substantial. Chart 14 shows the security costs to business as a percentage of turn-over. Whilst 57% of businesses reported that their security costs as a percentage of sales were between 1% and 10%, 16% of firms reported that security costs constituted between 11% and 50% of sales. On average, the security costs as a percentage of sales were 5.8% in 2007 compared with 4.6% in 2002.

Not only does the poor security situation affect the costs and the productivity of PNG businesses, but also it negatively affects investment decisions. Chart 15 shows how the decision to invest or expand operations has been impacted by crime. Over half the respondents indicated that the decision to invest or expand their business had been either very highly or highly affected by the chronic state of law and order. There had, however, been a small improvement compared with the survey in 2002.

Chart 14: The Security Costs to Business a Percentage of Sales
The 2007 survey confirms that PNG’s law and order situation remains a serious issue for the business community. While, at best, there may have been a marginal improvement in businesses’ perceptions of the law and order situation since the 2002 survey, the response indicate that the direct costs to business (in terms of internal security costs) have increased.

Over the medium to longer term, many of the underlying causes of PNG’s law and order problems can only be addressed by increased employment and income earning opportunities, and by alleviating poverty more generally. However, the economy’s capacity to sustain high rates of employment growth through productive investment is being constrained by the current law and order problems. Hence, there is an immediate need for a more effective law and order policy that encompasses the three tiers of policing, prosecution and detention. The fundamental requirements for a secure law and order environment are: (1) a strong police force with a high degree of success in apprehending offenders so that criminals can expect that there is a strong chance of being apprehended for committing a crime; (2) solid legal processes and institutions to successfully bring convictions to offenders; and (3) ensuring that punishment fits the crime and that jail sentences are served in full (Levantis and Manning, 2002).

**Constraints to Business and Investment**

As part of the survey, businesses were asked to rank 22 potential constraints according to their impact on the business environment. Respondents were asked to rank constraints on a six-point scale ranging from "no problem" to "extremely problematic". Chart 16 shows the ranking of the constraints that the respondents identified as posing the most important problems for doing business in 2007. The major impediments to doing business in 2002 are also included for comparison purposes.

Consistent with other responses to the survey, businesses reported that the most significant problems were "law and order", "corruption", "political uncertainty" and the state of the nation’s infrastructure. Other major issues identified as substantial hindrances to business and investment were "access to land" and "land compensation claims". By contrast, macro-economic issues embodied in exchange rate instability and the high interest rates, that were ranked as among the most problematic issues in the 2002 survey, were not reported as such major problems in 2007, which reflects the
markedly improved macro-economic situation in Papua New Guinea over the past five years.

The ranking of issues in this section tracks closely the constraints identified in the other parts of the survey, providing a good consistency check of overall accuracy of the answers to the questions.
In all areas that were investigated, the respondents to the survey indicated substantial problems. Concerns regarding political stability remain in spite of an extended period in which the government of Sir Michael Somare has been in office. The business community appears to have little confidence in the ability of government to supply services and remains highly dissatisfied with the quality of services available. Corruption is viewed as a widespread and increasingly pervasive phenomenon, which is consistent with the finding that when rules and regulations are burdensome, allow undue discretion to Ministers and officials and are changed frequently, public officials are able to extract “irregular payments” from businesses. Law and order problems continue to weigh heavily on businesses, amounting to the equivalent of a substantial tax on profits. Investment decisions have been affected by the difficulty of complying with rules and regulations imposed by various government departments and agencies.

It is also clear from the survey responses that investors in PNG have long memories, so that the political stability of the past 6 years has had less impact than might have been expected, perhaps when linked with perceived policy uncertainty and inconsistency. The business community follows closely ministerial reshuffles and changes to the heads of key government departments and agencies. The business community may also believe that the underlying political dynamic that has led to political instability in the past has been only partly addressed by reforms such as the Organic Law on the Integrity of Political Parties and Candidates and therefore fear future outbreaks of uncertainty. Since Independence in 1975, no-confidence motions and changes of government on the floor of Parliament occurred frequently, and although there were no no-confidence motions or changes of government in the seventh National Parliament (2002-2007), business may require a continuation of stability in the eighth National Parliament (2007-2012) before there is a major shift in perceptions on political stability.

Comparison with the Findings of the Private Sector Assessment

Chart 17: Business View of their Top Priority to Encourage Business and Investment (percentage of Business by Issue)

As part of the survey businesses were asked to rank their most important policy priorities. An overwhelming majority of those surveyed indicated that law and order should be the prime focus of policy. Closely related, was the emphasis respondents placed on dealing
with the corruption issues (largely specified as the second priority). Infrastructure was identified as the third priority, especially transport and telecommunications.

The binding constraints to growth identified in the Private Sector Assessment for PNG mirrored closely the issues identified in the survey. The most important constraints in the PSA are:

- High risk resulting from; a high crime rate; a lack of transparency in government; unpredictable changes in government policy; a weak commercial legal framework, including a poor collateral system; an uncertain and complicated land leasing system.
- High transactions costs resulting from government intruding in every area of the economy through ownership and regulation, raising costs and weakening competitiveness.
- Poor infrastructure, especially road infrastructure, which has been described as a massive and pervasive problem in PNG. Inefficient state-owned enterprises (SOEs) provide poor, high-cost service and crowd out the private sector.
- Underdeveloped financial markets with low lending and high interest rates

These conclusions are to a large extent confirmed by the business survey and highlight the need for reform. Although in the short run, the natural resource boom has changed the economic landscape in PNG and growth and investment have been strong, ensuring that growth spills over into much of the rest of the economy, sustainable growth requires broad based reform. Many countries that have experienced growth from natural resources fail to sustain the expansion once commodity prices decline, as they inevitably do. The current boom provides PNG with an opportunity to broaden its economic base and provide for sustained growth in the future that relies not only on natural resources but a more diverse range of economic activity. Failure to remove the bottlenecks, target public expenditure on priorities, constrain corruption and other handicaps to broad-based business and investment, and maintain sound macroeconomic management (allowing the “Dutch Disease” to become unduly pervasive) will jeopardise the country’s economic prospects, including needed employment growth.

**Policy Reform**

The conclusions of the survey and the PSA lead to similar policy recommendations. The most important of these are:

i. Vigorously promoting competition by eliminating SOE monopolies and ensuring that the private sector is also forced to compete. The dramatic reduction in calling costs and expansion of services as a result of the partial opening up of the mobile telephony market to competition (in mid-2007) illustrates the benefits of having new entrants in sectors that have been monopolised. Generally, policies should be directed at reducing costs and improving service, instead of protecting incumbent SOEs.
ii. Promoting (sound and transparently awarded) public–private partnerships to increase investment and improve productivity in infrastructure and service provision.

iii. Ensuring sound and consistent macroeconomic and fiscal management, with public expenditure on agreed priorities, as specified in medium-longer term strategies, at all level of administration (national and sub-national), entailing strong and independent mechanisms of official oversight, and increased public awareness and participation (including by the private sector) in planning and oversight.

iv. Providing robust and adequately funded independent mechanisms for addressing crime, including public (and private) sector corruption, and able to provide a tangible deterrent effect.

v. Modernising the legal system to better meet the needs of modern commerce and reflect the realities of PNG. Initially, the Companies Act and the companies registry require reform, which should accommodate rural and community organisations.

vi. Simplifying the system of licenses, regulations, and taxes that raise the costs of doing business. This will especially help small and medium enterprises.

vii. Promoting financial market development by reforming the collateral framework, assisting in the development of credit information, and promoting access to financial services in rural areas.

viii. Vigorously pursuing public sector reform, including right-sizing of institutions and staffing levels to meet public needs and priorities (including those of the private sector); this entails in many cases cutting back on waste and excessive overheads and staffing, but in other cases increasing staffing levels or providing more specialist staff (or contracting out functions) to meet needs (e.g. with respect to bottlenecks such as migration, work permits, as well as meeting growing education and training needs and infrastructure design and contract oversight).

ix. Formalising private and public sector consultation mechanisms to arrive jointly at a consensus regarding reform initiatives and priorities. This will entail strengthening the ability of representative private sector organizations to analyse policy options.
1. CONTEXT AND INTRODUCTION

1.1 THE PAPUA NEW GUINEA BUSINESS AND INVESTMENT ENVIRONMENT

In contrast to 2002 when the last survey was conducted, 2007 has been a positive year for the Papua New Guinea economy. It has been a year of relatively strong economic growth, with fortuitously high prices for the country’s major export commodities, notably for copper, oil, gold and, to a lesser extent, some agricultural products. The high commodity prices of recent years have contributed to improved economic activity and higher employment in most sectors. It has also underpinned a marked improvement in the balance of payments and external reserve position, and provided windfall revenues for government. The improved economic and business environment is also a result of political and institutional reforms introduced in the early 2000s (which have contributed to political stability), together with the application of fiscal restraint since 2003.

**Economic Growth:** Economic data in PNG, including on GDP, are notoriously unreliable and outdated. Nevertheless, there have been four years of steady economic growth, driven largely by strong commodity prices and forecast to continue in 2008. In real terms, growth in non-mining GDP in 2006 was estimated at 3.7%, exceeding the population growth by about 1%, and projected by Treasury at 6.5% for 2007 (figure 1). This is comparable to the global average growth rate, but remaining relatively low (and belated) when compared to growth rates for many other developing countries (with very strong growth in China, and to a lesser extent India, also fuelling export demand in smaller developing economies).

**Figure 1: GDP Growth Rates 2002-2007**

![GDP Growth Rates 2002-2007](image)
Table 1: Other Key Economic Indicators:

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline inflation (ave on ave %)</td>
<td>11.8</td>
<td>14.7</td>
<td>2.1</td>
<td>1.7</td>
<td>2.3</td>
<td>1.8</td>
<td>5.2</td>
</tr>
<tr>
<td>Exchange Rate (TWI)</td>
<td>31.5</td>
<td>31.09</td>
<td>31.79</td>
<td>32.06</td>
<td>32.78</td>
<td>31.44</td>
<td>n/a</td>
</tr>
<tr>
<td>AUD per Kina</td>
<td>0.474</td>
<td>0.433</td>
<td>0.422</td>
<td>0.423</td>
<td>0.434</td>
<td>0.403</td>
<td>n/a</td>
</tr>
<tr>
<td>USD per Kina</td>
<td>0.257</td>
<td>0.282</td>
<td>0.310</td>
<td>0.322</td>
<td>0.327</td>
<td>0.338</td>
<td>n/a</td>
</tr>
<tr>
<td>Interest Rate : TBills %</td>
<td>13.3</td>
<td>18.3</td>
<td>9</td>
<td>4.5</td>
<td>5</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Foreign Exch Reserves (k mill)</td>
<td>1,376.5</td>
<td>1,742.7</td>
<td>2,072.3</td>
<td>2,367.9</td>
<td>4,344.7</td>
<td>5,917.0</td>
<td>n/a</td>
</tr>
<tr>
<td>Broad money supply (M3) (K mill)</td>
<td>3569.2</td>
<td>3410.5</td>
<td>3914.8</td>
<td>5069.3</td>
<td>7040.2</td>
<td>8,993.4</td>
<td>n/a</td>
</tr>
<tr>
<td>M3 % change</td>
<td>7.3</td>
<td>-4.4</td>
<td>14.8</td>
<td>29.5</td>
<td>38.9</td>
<td>27.7</td>
<td>n/a</td>
</tr>
<tr>
<td>Public Debt total (K mill)</td>
<td>8,365.3</td>
<td>7,924.0</td>
<td>7,590.7</td>
<td>7,259.8</td>
<td>6,732.1</td>
<td>6,472.5</td>
<td>6,270.1</td>
</tr>
<tr>
<td>debt % of GDP</td>
<td>71.8</td>
<td>63.1</td>
<td>60</td>
<td>47.6</td>
<td>39.5</td>
<td>34.9</td>
<td>31.8</td>
</tr>
<tr>
<td>domestic debt (k mill)</td>
<td>2,588.3</td>
<td>3,022.9</td>
<td>3,181.2</td>
<td>3,403.8</td>
<td>3,101.0</td>
<td>3,135.1</td>
<td>3,211.8</td>
</tr>
<tr>
<td>foreign debt (k mill)</td>
<td>5,777.0</td>
<td>4,901.1</td>
<td>4,409.5</td>
<td>3,856.0</td>
<td>3,631.1</td>
<td>3,337.3</td>
<td>3,058.2</td>
</tr>
<tr>
<td>For. Debt as % of Total</td>
<td>69.1</td>
<td>61.9</td>
<td>58.1</td>
<td>53.1</td>
<td>53.9</td>
<td>51.6</td>
<td>48.8</td>
</tr>
<tr>
<td>Debt servicing cost (K mill)</td>
<td>436.4</td>
<td>739.6</td>
<td>377.0</td>
<td>332.8</td>
<td>307.0</td>
<td>372.9</td>
<td>373.5</td>
</tr>
</tbody>
</table>

**Inflation:** While inflation has been low and steady since 2004, inflationary pressures began to emerge during the course of 2007, and is reflected in the 2008 projection for a sharp rise in prices. The strengthening of inflationary pressures largely reflects developments in the global economy (notably the increase in oil and food prices) although continued strong growth in government expenditure is also fuelling domestic price increases combined with supply constraints in parts of the economy (including urban land, skilled labour and utilities, some caused by bureaucratic bottlenecks and the monopoly power of some SOEs).

**Exchange Rate:** Over the period 2002 to 2007, the Kina appreciated against the US dollar, but depreciated against the Australian dollar and most other major trading partners. On a trade weighted basis, the Kina was largely unchanged over this period.

**Interest Rates:** interest rates have also remained low and steady since 2005, reflecting relatively modest inflation, limited State borrowing requirements and the neutral stance of monetary policy.

**Debt to GDP:** public debt has fallen from about 70% of GDP in 2003 (with 70% comprising foreign debt), to a forecast level of 34.9% at the end of 2007 (with a roughly even split between foreign and domestic debt). While this is a marked achievement, the improvement largely reflects positive ‘debt dynamics’, notably solid GDP growth. From the end of 2003 to the end of 2007, total public debt outstanding declined from K7.9 billion to a projected K6.5 billion, which is still high and risky, and requires an annual outlay of K373 million in interest payments. As a consequence, and in light of the capacity constraints that are impeding the effectiveness of the Government’s expenditure programs, a strong case can be made that the Government should be directing a greater proportion of its revenue windfalls to debt reduction. In relation to external debt, this may
entail negotiation with international lenders to avoid costly penalty clauses from premature repayment.

**Foreign Exchange Reserves:** reflecting the strong performance of PNG’s exports, notably oil and minerals, external reserves have risen from K1.4 billion in 2002, or 5 months of total import coverage to a very comfortable K5.9 billion at the end of 2007 (9.3 months total cover). Given the volatility of international commodity prices, a high level of external reserves is required for prudent macroeconomic purposes.

**Money Supply (M3):** there has been very strong growth in the money supply in recent years due to the marked increase in net foreign assets of the banking sector (including the Central Bank) and relatively strong credit growth. This high level of liquidity will need to be closely monitored by the Central Bank as it poses a threat to the exchange rate and price stability.

**Employment:** National statistics (from the National Statistical Office) have become increasingly deficient since the late 1980s, including on business activity and employment. However, the Bank of Papua New Guinea’s business (sample) survey indicates that PNG’s formal sector employment grew by a strong 10 per cent in 2007, to be 28 per cent above the level recorded in 2002. Growth has covered all sectors, especially building and construction, agriculture and wholesale, and to a lesser extent mining. It must be recognised, however, that formal employment only embraces a small portion of PNG’s population (although those employed in the formal sector invariably support a large number of extended family members).

The improved rate of economic growth is a welcome achievement, indicating that a number of positive steps have been taken in recent years to create the platform for economic recovery. Nonetheless, firmer reforms are required if this growth is to be sustained and reinforced, and in order to spread the benefits more extensively through the economy, especially in rural areas. There is a need to substantially raise employment and income-earning opportunities throughout the economy (and avoid the negative effects of the “Dutch Disease”, particularly in the face of major potential resource projects, notably a prospective LNG project). Necessary reforms must include addressing prevailing, serious and largely man-made impediments to business and investment, including restraints on competition, lack of investment and essential public goods, including maintaining core infrastructure and services (and addressing law and order problems and corruption) and tackling unnecessary red tape.

In the World Bank’s “Ease of Doing Business” report (2008), PNG ranked 84th out of 179 countries. This was substantially lower than some of PNG’s regional (developed) economies, such as New Zealand (in 2nd place) and Australia (9th), but also poor in relation to the other Pacific Islands (developing) nations: -

<table>
<thead>
<tr>
<th>Country</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tonga</td>
<td>47</td>
</tr>
<tr>
<td>Samoa</td>
<td>61</td>
</tr>
<tr>
<td>Kiribati</td>
<td>73</td>
</tr>
<tr>
<td>Marshall Is</td>
<td>89</td>
</tr>
<tr>
<td>PNG</td>
<td>84</td>
</tr>
<tr>
<td>Solomons</td>
<td>79</td>
</tr>
<tr>
<td>Palau</td>
<td>82</td>
</tr>
</tbody>
</table>
Within some categories PNG is ranked higher, for example in relation to employment conditions (33rd) and registering a business (64th). It ranked poorly, however, in certain other categories, notably obtaining credit (115th), licensing (118th or 217 days average time to obtain a license), and extremely poorly in terms of enforcing contracts (162nd).

2. 2007 PRIVATE SECTOR SURVEY PROFILE AND METHODOLOGY

2.1 INTRODUCTION

In an endeavour to understand the major impediments and difficulties of the private sector business and investment environment in Papua New Guinea, the Institute of National Affairs (INA) undertook the 2007 Private Sector Survey. The survey was funded by the ADB and designed to provide a comparison with the findings of a similar exercise undertaken in 2002. The survey incorporated 26 questions under the following six general headings:

- Information about the business;
- Government regulations and policies;
- Business security;
- Government business relationships;
- Effectiveness of government service provision; and
- Rating hindrances to business and investment.

The questions were designed to monitor the views of businesses, (i.e., small, medium and large) on a number of significant issues under the aforementioned broad headings and to gauge the relevance of those issues with respect to their business operations.

The survey was conducted between May and June 2007. Businesses completed the questionnaire via four means: (1) through the postal network, (2) the INA’s corporate website and email, (3) facsimile transmission, and (4) delivering the survey questionnaires directly to businesses by field assistants. Under the latter arrangement survey questionnaires were provided to smaller business and data was entered with assistance from the respective field assistant, if sought.

No focus group discussions were held with the businesses. Nor did the survey resort to other data collecting methodologies. However, a few authoritative information sources and literature were cited to draw the assessments contained herein. A total of 243 questionnaires were successfully completed and returned (compared to 166 for the 2002 survey). The survey questionnaire is reproduced in Appendix 1. The general survey methodology was to ask the respondents to gauge, on a 6-point scale, the degree to which the issue in question affects their business and investment operations. The issues covered in the survey are those commonly cited as affecting business and investment in PNG.
3.1 THE PROFILE OF THE BUSINESSES

The survey requested (on a confidential basis) information on the operations of the respondent businesses and was aimed at obtaining data on the following seven areas:

1) Form of business ownership (whether PNG-owned, overseas-owned or a joint venture);
2) Location of the business, (whether operating in an urban or rural setting);
3) Registration status of the business;
4) Length and/or stability of the business operation;
5) Annual turn-over of the business;
6) Nature of industry or economic sector that the business is operating in; and
7) The exporting profile of the business.

3.2 BUSINESS OWNERSHIP PROFILE

Of the businesses that participated in the private sector survey, 56% were locally-owned, followed by overseas-owned with 28% and joint-venture business arrangements with 16% (figure 1).

Figure 2a: Profile of Respondents by Business Ownership

3.3 BUSINESS LOCATION

The largest number of respondents (46%) operated businesses in towns outside the main urban centres of Port Moresby and Lae, (Figure 2). The second largest number operated from “multiple locations”, which includes businesses operating in both Port Moresby and Lae. Port Moresby-based businesses accounted for 21% of the respondents, with Lae only

Note, this figure shows the ownership status of sampled firms, as opposed to the level of equity in sampled enterprises referred to in section 3.9.
8%. As demonstrated by these results, in designing the survey an explicit effort was made to obtain wide coverage from across all provinces, and to capture firms that operated outside PNG’s two major urban centres.

**Figure 1b: Profile of Respondents by Location of Business**

Even so, the vast majority of the respondents, (87%), were urban-based businesses. Only 8% of the businesses were solely rural-based, while the balance of 5% operated in both the urban and rural settings (see: Figure 3). This directly reflects the current business and investment environment where few businesses are located in rural areas due to poor access to public goods and reliable and competitive services (including telecommunications). For non-exporting businesses, the poorly developed cash economy in much of rural Papua New Guinea is also another reason why very few chose to operate in rural areas.

**Figure 2: Urban vs. Rural Profile of Respondent Businesses in the Survey**
3.4 THE REGISTRATION PROFILE OF BUSINESSES

Nearly all respondents, 99%, were registered businesses conducting legal business and investment operations, (Figure 4).

In PNG, many small enterprises are in the informal sector and opt to remain so in view of perceptions or actual experience with the red tape of registration, additional workload, potential tax obligations and limited apparent benefits from “formalising”\(^5\). That said, there are clearly many smaller businesses which have registered to conduct legal operations. The formally registered businesses are often more visible and willing to participate in national surveys (such as this), whilst many unregistered businesses are less cooperative, for fear of disclosing their business practices and locations to government agencies. Some small foreign-owned and operated businesses appear to constitute a significant portion of the latter group, with the response from them to this survey negligible, despite some effort to encourage their participation.

As a policy issue, an effective business tracking and monitoring system is required. Those business entities operating informally may engage in illegal activities, such as pirating of merchandise, and are evading taxes. There have also been allegations of late of the sale of illegal/unproven pharmaceutical drugs, usually by unregistered businesses, which potentially pose a serious threat to the health of Papua New Guineans. Establishing suitable conditions for small enterprises to “formalise” and enforcing registration requirements on larger (including foreign-owned) businesses, would also broaden the economy’s tax base.

**Figure 3: Registration Profile of Business**

\(^5\) Informal Sector Survey, IFC, 2007
3.5 THE LENGTH AND/OR STABILITY OF BUSINESS OPERATIONS
Twenty percent of the respondents were new businesses that started operations during the course of the last five years (Figure 5). However, the majority of the respondents, (80%, see: Figure 5) were long-established businesses. An inference may be drawn from this statistic that there was general business stability over the last five years, without extensive business failure (or takeover).

Figure 4: Old vs. New Business Profile (percentage)

3.6 SIZE OF THE BUSINESSES BASED ON ANNUAL TURNOVER
The three categories of annual turnover used in the study are:
(1) Less than K500,000. The businesses that fell within this turnover range were considered as small-businesses;
(2) Between K500,000 and K5,000,000. The businesses that fell within this turnover range were considered as medium-businesses; and
(3) More than K5,000,000. The businesses that fell within this turnover range were considered as large businesses.

Forty five per cent of respondents were large businesses; 27% fell into the medium business category and 26% in the small category, while 2% did not clearly specify the value of their turnover (Figure 6a). This contrasts with the 2002 survey with 52% respondents being large businesses, 37% medium and 11% small, and reflects the intent of the 2007 survey to include a greater number of smaller businesses.
Figure 6b: Size of Business based upon Annual Turnover

Broken down by region (Figure 6b): in Momase (which includes Lae), the majority of respondents (61%) were classified as large businesses, with 10% classified as small. Similarly in the Southern Region (which includes Port Moresby) 57% were large, with 15% small. By contrast, in the Islands region 51% fell into the small business category and only 20% were large businesses. In the Highlands region the respondent categories were more evenly balanced with 39% small, 37% large and 24% medium.

Figure 6b: Size of (respondent) Business based upon Annual Turnover by Region
3.7 CATEGORIES OF INDUSTRY

The respondents were categorised across ten broad economic industry groupings: (1) agriculture, forestry and fisheries; (2) building and construction; (3) finance, business and investment; (4) hotels, restaurants and bars; (5) manufacturing; (6) mining and quarrying; (7) retail and wholesale; (8) transportation and communication; (9) utilities, and (10) other services (e.g. gaming, hairdressing etc).

Figure 8a classifies the respondents into broad industry groupings as a percentage of the total number of firms in the INA survey. The number of businesses in each grouping is then compared to the estimated total number of firms in each sector, based upon the National Statistical Office’s (NSO) official estimates of total businesses (Figure 8b). The quality of the NSO figures is uncertain, but their data is reported to be updated regularly. On the basis of the NSO figures, it appears that a reasonable representation was gathered in the INA sample from each industry group. The utilities (gas, water and electricity) grouping scored the highest representation rate at 5.2%. This is because there are only a few firms operating in that grouping.

**Figure 7a: Respondents by Industry in INA Survey (percentage of all firms in the survey)**
3.8 FOREIGN EQUITY

Consistent with previous surveys, foreign equity participation in the businesses surveyed is very significant, particularly in certain industries, (Figure 9). Also consistent with the previous studies, the large firms had the greatest concentration of foreign equity. For all firms surveyed, 36 per cent of the equity on average was held by foreign interests. By industry category, over 52% of manufacturing businesses were owned by foreign interests. This is followed closely by transport and communication with 47%. Building/construction and mining/quarrying are next with around 46% apiece. The lowest penetration of foreign equity is in the agriculture, fisheries and forestry sector (23%), followed by the finance, investment and business sectors (25%).

In the 2002 the average level of foreign holdings amongst the sample survey was 54%, and the lower figure in 2007 (36 per cent) largely reflects the higher number of small to medium enterprises sampled in the recent survey and perhaps also the increased local equity capital available, e.g. through superannuation funds, by resource owners and other mechanisms.

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6 this is the average of all the enterprises, not an aggregate figure of the total worth of the sampled businesses, some of which were much larger than others.
3.9 EXPORTING PROFILE OF RESPONDENTS

Around 81% of the respondents were not engaged in exporting (see: Figure 7). Nineteen percent were engaged in some exporting, which included 6% engaged in exporting as a major portion of their overall turnover, whilst 13% were involved in exporting as a minor proportion of their business.

Figure 9: Exporting Profile of Respondents
3.10 EXPORTING BY INDUSTRY

Out of the 19% of the businesses engaging in some form of exporting, a significant proportion (around 49%) operated in the agriculture, forestry, fisheries and the mining/quarrying sectors (Figure 10). The previous surveys revealed similar characteristics. However, there is a slight increase (i.e. to 3.8%) in the financial services sector due to some PNG-based firms expanding operations abroad.

**Figure 10: Proportion of Exports in each Industry’s Output**

4. GOVERNMENT REGULATIONS AND POLICIES.
4.1 Introduction

Stable policies, rules and regulations, and simplicity and certainty in their application, are fundamental prerequisites for a sound business and investment environment. During the 1990s, PNG’s record in relation to business perceptions over the stability of rules was undermined by general political instability, a breakdown in macroeconomic discipline and an erratic and inconsistent track record in relation to policy reform.

In 1999, the newly elected (Morauta) Government sought to rebuild business confidence including providing the Central Bank independence over monetary policy, freeing the superannuation funds from undue government influence whilst improving their oversight, launching a privatisation process and introducing far ranging reforms aimed at enhancing policy and political stability, including the Organic Law on the Integrity of Political Parties & Candidates (OLIPPAC) in 2000. Notwithstanding these efforts, a breakdown in fiscal discipline in 2001 and early 2002 contributed to a weakening of business confidence which may have served to undermine the (Morauta) Government’s earlier achievements.

As noted in Section 1 above, economic conditions in Papua New Guinea have improved considerably over the past 5, and the coalition Government (2002 to 2007) was the first in PNG’s history to complete a full five year term. Moreover, a coalition with a similar composition retained power following the National Elections in 2007. In this context, it may be expected that businesses have a significantly more positive outlook towards issues such as the stability of rules, regulations and policies. The responses to this section of the survey can be used to assess this premise.

4.2 Question A1:
Level of Concern for the Stability of the Rules, Regulations and Policies

The first question\(^7\) of the survey was designed to gauge the level of concern over the stability of rules, regulations and policies that affect the respondent business. On average, 52% of businesses were “very concerned” or ‘highly concerned” over regulatory and policy stability (Figure 8a). In contrast, only 2 per cent were unconcerned. Across each industry category all industries expressed concern over the stability of rules, regulations and policies that affect their business (Figure 8b). Importantly, there has been no significant easing in the level of concern recorded in 2007 survey compared to the 2002 survey. Overall, businesses remain concerned over the stability of the ‘rules of the game’ imposed by Government. In turn, this perception can be expected to impact negatively on PNG’s investment outlook, including by increasing the political risk of doing business in the country.

Figure 11a: Level of Concern for the Stability of Rules, Policies & Regulations

\(^7\) The questionnaire is reproduced in Appendix 1.
Note: The results give all the industries’ responses in terms of percentages.

Figure 11b: Level of Concern for the Stability of Rules and Regulations by 6-point scale

Notes: The results give average scores by industry on a 6-point scale where 1 = completely unconcerned, 2 = highly unconcerned, 3 = fairly unconcerned, 4 = fairly concerned, 5 = highly concerned, and 6 = very highly concerned.

4.3 Question A2
Fear of Retrospective Changes to Rules and Regulations
The second closely related question requested respondents to advise on whether they “feared retrospective changes to rules and regulations”. This issue is also central to the credibility of the regulatory and policy environment faced by business and in turn, the degree of risk associated with new investments. If businesses are concerned over retrospective changes to rules and regulations, they may apply a high risk premium to the financial assessment of new investment proposals and other operational matters. This risk premium could mean the difference between new investment proceeding or being abandoned.

Once again, the majority of businesses (52%) were either ‘very highly concerned’ or ‘highly concerned’ over the possibility of retrospective change to rules and regulations (Figure 13a). As with the first question, there was considerable consistency across broad industry groups (Figure 13b). While there appears to have been a marginal improvement in the level of concern over retrospective changes between the 2007 and 2002 surveys, this is not judged to be significant, particularly given the slightly different sample of businesses interviewed in the two surveys.

Figure 12a: Fear of Retrospective Changes to Rules and Regulations

![Bar chart with percentage weightings]

Note: The results give all the industries’ responses in terms of percentages.

Figure 12b: Fear of Retrospective Changes to Rules and Regulations
Notes: The results give average scores by industry on a 6-point scale where 1 = completely unconcerned, 2 = highly unconcerned, 3 = fairly unconcerned, 4 = fairly concerned, 5 = highly concerned, and 6 = very highly concerned.

4.4 Question A3
Level of Information and Consultation in Developing Policy and Regulations

The process of policy dialogue, analysis, information dissemination, and feedback between the Government and relevant stakeholders, including unions, business organisations and civil society, plays an important role in the design of appropriate policies. When consultation is not undertaken, policy shifts and even key reforms can generate suspicion and consternation among the effected parties. This often results in criticisms being levelled against the Government and its agents thus fuelling an environment lacking in partnership and cooperation, and accentuating feelings of mutual distrust.

The question requested respondents to indicate to what extent they were informed or consulted during the design of regulations, rules and policies. Forty per cent of businesses indicated that they were seldom or never consulted/informed on policy development, while only 20% of businesses indicated that they were always or mostly consulted/informed (Figure 13a). That said, this question at least suggests that there has been some improvement in the consultative processes since the 2002 survey, with the most marked improvement being recorded in the hotel and restaurants category (figure 13b). This improvement may indeed reflect the efforts of government agencies to improve consultation mechanisms or, alternatively, it may reflect the actions of civil society organisations (such as the Consultative Implementation and Monitoring Council) to strengthen the fora for government-business dialogue.

**Figure 13a: Level of Information and Consultation in the Development of Policy**
4.5 Question A4

Confidence in the Implementation of Policy Announcements

Businesses were asked how confident they were that major policy announcements would be fully implemented. This question is central to the credibility of a government’s policy platform. Forty six per cent of businesses responded that they were seldom or never confident in the implementation of policy announcements while only 7 % were mostly or always confident (Figure 14a). That said, there appears to be some improvement in the confidence level since the 2002 survey (Figure 14b). Even so, given that the Somare Government served a full five year term in the last parliament, a more pronounced improvement may have been expected.

Figure 14a: Confidence in the Implementation of Policy Announcements
Note: The results give all the industries’ responses in terms of percentages.

Figure 14b: Confidence in the Implementation of Policy Announcements

Notes: The results give average scores by industry on a 6-point scale where 1 = always confident, 2 = mostly confident, 3 = frequently confident, 4 = sometimes confident, 5 = seldom confident, and 6 = never confident.

4.6 Question A5
Propensity for Rules and Regulations Impacting Business to Change with Changes in Government

Businesses were asked to determine to what extent changes in government were accompanied by changes in rules and regulations that had an impact on their particular activities. Forty seven per cent of businesses either ‘fully agreed’ or ‘agreed in most cases’ that a change in government was usually accompanied by changes in rules and regulations, while only 6 per cent ‘disagreed strongly’ or ‘disagreed in most cases’ (Figure 15a). On average, there was no change in business sentiment on this issue between the 2007 and 2002 surveys (Figure 15b).

In general, changes to rules and regulations following a change of Government are to be
expected in a democratic society such as PNG. Indeed, incoming Governments hold the view that they have been given a policy mandate to implement such changes. That said, in terms of the business and investment environment, changes to rules and regulations that lack coherency or do not reflect the new Government’s policy platform can prove very damaging to the business and investment environment, not least because they fuel uncertainty. It is not, however, possible to assess the results of this survey question against this perspective.

**Figure 15a: Propensity for Rules and Regulations impacting upon Business to change with Changes of Government**

![Bar chart showing the percentage of industries agreeing with the statement that rules and regulations impact upon business with changes of government.]

**Figure 15b: Propensity for Rules and Regulations impacting upon Business to change with Changes of Government by 6-point scale**

![Bar chart showing the percentage of industries agreeing with the statement that rules and regulations impact upon business with changes of government by a 6-point scale.]
Notes: The results give average scores by industry on a 6-point scale where 1 = strongly disagree, 2 = disagree in most cases, 3 = tend to disagree, 4 = tend to agree, 5 = agree in most cases, 6 = fully agree.

4.7 Question A6
Impact on Business due to Political Uncertainty

Ongoing political uncertainty can be damaging to a country’s business and investment environment, particularly if undermines confidence in the stability of policies and regulations. Businesses often respond to political uncertainty by reducing the time horizon for their investment decisions, meaning that they may forgo investments that require long payback periods (i.e., the number of years required for the investment to be repaid) even though the investment may provide high economic returns. Instead, they may focus on investments and activities which provide a more immediate return. However, a focus on a relatively short term investments is unlikely to be in a country’s national interest.

This question sought to establish whether businesses in PNG believed that their operations were affected during periods of political uncertainty. Fifty four per cent of business believed that their businesses were ‘very highly affected’ or ‘highly affected’ by political uncertainty while only 2 per cent responded that they were ‘completely’ or ‘highly’ unaffected (Figure 16a). That said, there appears to have been a marginal improvement in such perceptions in the 2007 survey compared to the 2002 survey (Figure 16b).

Figure 16a: Impact on Business during Periods of Political Instability
Note: The results give all the industries’ responses in terms of percentages.

Figure 16b: Impact on Business during Periods of Political Instability by 6-point scale

Notes: The results give average scores by industry on a 6-point scale where 1 = completely unaffected, 2 = highly unaffected, 3 = fairly unaffected, 4 = fairly affected, 5 = highly affected and 6 = very highly affected.

4.8 Question A7
Concern for the Stability of the Political Environment in PNG

Whereas the previous question established that political uncertainty affected the majority of businesses surveyed, this question was designed to gauge their views on the stability of PNG’s political environment. A very high 76% of businesses responded that they were ‘very highly’ or ‘highly’ concerned over the stability of the political environment in PNG (Figure 17a). Only 4% were ‘fairly’ unconcerned while no respondent reported that
they were ‘highly’ or ‘completely’ unconcerned. While on average the level of concern for the stability of PNG’s political environment was high to very high, there does appear to have been some improvement (ie an easing of concern) since the 2002 survey (Figure 17b).

The high degree of concern expressed over the stability of PNG’s political environment is particularly surprising given that the Somare Government served the full 5 year term of the last Parliament. Then again, the survey results may indicate that the business community views political stability in a wider context than simply the tenure of the Prime Minister. Other issues that may have been taken into account include Ministerial reshuffles and the replacement of the heads of key government departments and agencies. As well, the results may indicate that business believe the underlying pressures that have led to political instability in the past remain in place and have not necessarily been addressed by reforms such as the Organic Law on the Integrity of Political Parties and Candidates.

**Figure 17a: Concern for the Stability of the Political Environment**

![Figure 17a](image_url)

*Note: The results give all the industries’ responses in terms of percentages.*

**Figure 17b: Concern for the Stability of the Political Environment by 6-point scale**

![Figure 17b](image_url)
Notes: The results give average scores by industry on a 6-point scale where 1 = completely unconcerned, 2 = highly unconcerned, 3 = fairly unconcerned, 4 = fairly concerned, 5 = highly concerned and 6 = very highly concerned

4.9 Question A8 & A9
Problems of Compliance with Government Regulations

This question comprised two components. The first asked whether businesses had ever decided against proceeding with a new investment because of problems relating to compliance with government regulations. If the business answered yes to this component, they were then asked to nominate the compliance issue that had the most bearing on their decision not to proceed with the investment.

In respect of the first part of the question, 47 % of businesses reported that they had decided against proceeding with a major investment because of problems relating to compliance with government regulations (Figure 18a). Of those businesses that responded in the affirmative in the 2007 survey, 43 % nominated ‘long processing time’ as the main compliance problem, while 30 % and 27 % nominated ‘too complex and haphazard’ and ‘excessive compliance fees’ respectively (Figure 18b). It is noted that in the 2002 survey, 44 % of respondents answered in the affirmative to this question, which suggests that there has been a marginal increase in compliance difficulties in recent years.

While investment regulation can be justified for a range of legitimate reasons, such as the need to ensure the protection of the environment and public health, the large number of businesses who reported that they had decided against proceeding with an investment due to compliance difficulties is a major concern. This concern is amplified when the respondents identify ‘long processing times’ as the major problem, as this implies that bureaucratic inefficiency is a significant factor impeding investment in PNG.

Figure 18a: Percentage Response to the Question on Whether Investments had
been Abandoned due to Compliance Difficulties

Note: This figure gives a break up of the main source of compliance problems as stated by those respondents answering “yes” above.

Figure 18b: Main Source of Compliance Problems

Note: This figure gives a break up of the main source of compliance problems as stated by those respondents answering “YES” to Question A9 above.

4.10 Government Regulations and Policies – Comment

Not surprisingly, the 2007 survey confirmed that political and policy instability, including retrospective changes in rules and regulations, are damaging for business confidence and, indeed, the operating environment for the private sector. What is somewhat surprising, however, is that business remains highly concerned over political and policy stability even though the Somare Government (2002 -2007) was the first in
PNG’s history to complete a full five year term. Moreover, and at best, there appears to have been only a marginal improvement (i.e. an easing of concern) in the views of business over political and policy uncertainty since the 2002 survey.

One explanation for this outcome is that the private sector may be adopting a long term perspective in assessing the issue of political stability in particular. Since Independence in 1975, no-confidence motions and changes of government on the floor of parliament occurred relatively frequently, and although there were no no-confidence motions or changes of government in the seventh National Parliament (2002-2007), business may require a continuation of stability in the eighth National Parliament (2007-2012) before there is a major shift in perceptions on political stability.

Alternatively, and as noted above, business may take into consideration over issues in assessing political stability, such as ministerial reshuffles and changes to the heads of key government departments and agencies. As well, the results may indicate that business is of the view that the underlying pressures that have led to political instability in the past have not necessarily been addressed by reforms such as the Organic Law on the Integrity of Political Parties and Candidates.

5. BUSINESS SECURITY

5.1 Introduction

A safe and secure society and a strong and effective legal system are key requirements for a well functioning private sector. A secure law and order environment is required to help ensure security over physical assets and indeed, the security of employees. Aside from the costs associated with theft, high crime levels will deter business and investment by increasing insurance premiums, increasing the cost of internally provided security (guards and security systems) and by increasing the costs associated with the employment of skilled labour from abroad. High crime levels can also impact adversely on a business’s productivity if employees are unwilling or unable to work night shifts. A strong and effective legal system is required to ensure that property rights and business contracts can be readily secured and effectively enforced. Without credibility in the legal enforceability of property rights, security over ownership of assets will be diminished and the incentive to accumulate wealth and invest in productive capacity will be eroded.

PNG’s poor law and order environment has attracted considerable attention and debate over the past two decades, both within PNG and abroad. It has regularly been cited as a major constraint to business activity and investment. The 2007 private sector survey provides an opportunity to assess whether the situation has improved in recent years, or whether it remains one of the most foremost constraints faced by business.

5.2 Question B1
Impact on Business Operations by the Law and Order Situation

This question asked respondents to determine the extent to which law and order problems have impacted upon their business. A sizeable 62% of businesses reported that they were either ‘very highly affected’ or ‘highly affected’ by the law and order situation in PNG (Figure 19a). A further 25% indicated that they were ‘fairly affected’. In contrast, only 3% of businesses reported that they were either ‘completely’ or ‘highly’ unaffected.

Notwithstanding the very high proportion of businesses who reported that they were affected by PNG’s law and order situation, there may have been a marginal improvement between 2007 and 2002 surveys (Figure 19b). A comparison between the two surveys suggests that the biggest improvement occurred in the mining and quarrying industries.

Figure 19a: Impact on Business of the Law and Order Situation

![Figure 19a](image)

Note: The results give all the industries’ responses in terms of percentages.

Figure 19b: Impact on Business of the Law and Order Situation by 6-point scale
Notes: The results give average scores by industry on a 6-point scale where 1 = completely unaffected, 2 = highly unaffected, 3 = fairly unaffected, 4 = fairly affected, 5 = highly affected and 6 = very highly affected.

5.3 [Question B2] Impact on Investment and Expansion Plans by Law and Order Situation

This question sought to gauge additional information on the impact of PNG’s law and order situation on business decision making. In this regard, businesses were asked whether the law and order situation had affected decisions to invest or expand operations. A sizeable 53% responded that their decisions to invest or expand operations had been either ‘very highly’ or ‘highly’ affected by the law and order situation (Figure 20a). Only 7% responded that such decisions had been ‘highly’ or ‘completely’ unaffected. As was the case with the previous question, the 2007 survey suggests that there may have been a marginal improvement in the impact of law and order on businesses since 2002, with the biggest improvement also being recorded by the mining and quarrying sector (Figure 20b).
Figure 20b: Impact on further Investment Decisions of the Law and Order Situation

Notes: The results give average scores by industry on a 6-point scale where 1 = completely unaffected, 2 = highly unaffected, 3 = fairly unaffected, 4 = fairly affected, 5 = highly affected and 6 = very highly affected

5.4 (Question B3)
Security costs as a percentage of turnover

The security costs to business as a percentage of turn-over due to law and order issues are shown in Figure 21a. While 57% of businesses reported that their security costs as a percentage of turnover ranged from 0.1 to 10%, a significant 16% reported that they
ranged from 11% to 50%. On average, the security costs as a percentage of turnover were estimated at 5.8% in 2007, which represents a significant increase on the 4.6% derived from the 2002 survey.

**Figure 21a: The Security Cost to Business as a Percentage of Turnover due to Law and Order**

![Figure 21a: The Security Cost to Business as a Percentage of Turnover due to Law and Order](image)

**Figure 21b: The Security Cost to Business as a Percentage of Turnover due to Law and Order by industry**

![Figure 21b: The Security Cost to Business as a Percentage of Turnover due to Law and Order by industry](image)

5.5 [Question B4]

Confidence in the Judicial System and the Decisions the Courts

This question asked whether businesses had confidence in PNG’s judicial system and the decisions of the Courts. As noted above, an independent and competent judiciary system
is a very important ingredient for business confidence and private sector growth. 17 per cent of respondents reported that they were either ‘very highly’ or ‘highly’ confident in the judicial system and court decisions. An additional 43 % were ‘fairly confident. In contrast, 19 % responded that they were either ‘highly’ or ‘completely’ not confident in the judicial system.

**Figure 22a: Confidence in the Judiciary and Court Decisions.**

![Confidence in the Judiciary and Court Decisions](image)

*Note: The results give all the industries’ responses in terms of percentages.*

**Figure 22b: Uncertainty and Indifference in Standards of the Judiciary as a Major Problem for Business**

![Uncertainty and Indifference in Standards of the Judiciary as a Major Problem for Business](image)

*Notes: The results give average scores by industry on a 6-point scale where 1 =*
completely not confident, 2 = highly not confident, 3 = fairly not confident, 4 = fairly confident, 5 = highly confident and 6 = very highly confident

5.6  [Question B5] Hindrance to Investment and Business due to Non-accessibility to Land

The difficulty in accessing land for development purposes in PNG is regularly cited as a major constraint to new investors and existing businesses. The survey sought to gauge the view of businesses on the issue, by asking respondents whether difficulties in gaining access to land had hindered them from investing in the country. Forty four per cent of businesses reported that land access difficulties had been a ‘big’ or ‘very big’ hindrance to their investment intentions, while 24 % reported that the issue had been a ‘minor’ or no hindrance$^8$ (Figure 23a). The 2007 survey also suggests that land acquisition difficulties may have increased since the 2002 survey, with significant rises in the hindrance level being recorded in the transport/communications, hotels/restaurants and ‘other’ industry categories (Figure 23b).

Figure 23a: Access to Land as Hindrance to Investment

Note: The results give all the industries’ responses in terms of percentages.

Figure 23b: Access to Land as Hindrance to Investment by 6-point scale

$^8$ It is noted that a significant 21 per cent of businesses either did not respond to the question or reported it as being not applicable.
Notes: The results give average scores by industry on a 6-point scale where 1 = not applicable, 2 = not a hindrance at all, 3 = minor hindrance, 4 = fairly big hindrance, 5 = big hindrance and 6 = very big hindrance

5.7 Business Security – Comment

The 2007 survey confirms that PNG’s law and order situation remains a serious issue for the business community. While, at best, there may have been a marginal improvement in businesses’ perceptions of the law and order situation since the 2002 survey, question B3 nonetheless suggests that the direct costs to business (in terms of internal security costs) have increased.

Over the medium to longer term, many of the underlying causes of PNG’s law and order problems will need to be addressed by generating increased employment and income earning opportunities, and by alleviating poverty more generally. However, the economy’s capacity to sustain high rates of employment growth is being constrained by the current law and order problems. Hence, there is an immediate need for a more effective law and order policy that encompasses the three tiers of policing, prosecution and detention. As noted in the 2002 private sector survey report, the three fundamental requirements for a secure law and order environment are: (1) a strong police force with a high degree of success in apprehending offenders; (2) solid legal processes and institutions to successfully bring convictions to offenders; and (3) the serving of punishment that is properly enforced and is sufficiently effective according to the degree of the crime (Levantis and Manning, 2002). Even though the 2007 survey confirms that land accessibility is a hindrance to business, it
may also be the case that the survey understates the extent of the problem. This may be so because the survey is obviously restricted to established business operations. It does not capture potential new investors (especially overseas investors) who may have decided against investing in PNG because of the land access issue. Fortunately, the Government appears to have elevated land reform as a priority development issue, including through the commissioning of the National Land Development taskforce. As well, K28 million has been allocated in the 2008 budget for land reform programs and activities. For there to be genuine progress in addressing this constraint, while accommodating the legitimate concerns of traditional landowners, this level of political commitment and financial support will need to be sustained well into the future.

6. GOVERNMENT-BUSINESS RELATIONS

6.1 Introduction

Effective interaction and working relations with the government’s regulatory bodies and agencies is also a very important component of a ‘business friendly’ operating environment. Unnecessarily rules and regulations, and burdensome approval process, add directly to the costs of doing business and increase the potential opportunities for corrupt or improper practices.

As noted in section 2 above, PNG rates poorly in the World Bank’s ‘Ease of Doing Business’ Index. As well, PNG performs poorly in the ‘Perceptions of Corruption’ Index which is compiled by Transparency International. In 2007, PNG was ranked 162 out of 180 countries surveyed by Transparency International, and 26 out of the 32 countries in the Asia Pacific Region. The questions in this section of the survey were designed to identify the controls and regulations that were of greatest concern to business, and to gauge businesses’ perceptions on the level and impact of corruption in regulatory agencies and bodies.

6.2 Question C1
Government Regulations and the Perceptions of Businesses

This question required businesses to rank government regulations on a 6 point scale ranging from ‘not a problem’ to ‘extremely problematic’. The rankings are shown in Figure 24. Based on the aggregate data, the regulations covering access to foreign labour were ranked as the most problematic for business. The regulations relate to work permits, visas and the restrictions on the occupations that can be held by foreigners. In addition, the level of business concern over these regulations appears to have increased marginally since the 2002 survey (Figure 25). On the positive side, a comparison of the two survey periods confirms the benefits of recent reform initiatives in the key areas of foreign exchange regulations (with the progressive liberalisation of foreign exchange

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9 In interpreting this data it should be noted that for the regulations listed, there was considerable variation in the responses across the various business categories. This variation is to be expected, as PNG’s regulatory framework impacts differently on the various business categories.
controls) and superannuation regulations (with PNG’s superannuation industry having been substantially reformed in recent years in order to improve efficiency and eliminate corruption).

Figure 24: Government Regulations and Licensing as a Problem for Business by 6-point scale (6 being extremely problematic, 1 of low concern)

6.3 Question C2
Overall Perceptions of Government-Business Relationships

This question required businesses to rank their overall working relationship with the government and the bureaucracy, with the rankings ranging from ‘very highly helpful’ to ‘very highly unhelpful’. Thirty nine percent of businesses responded that the government was ‘highly’ or ‘very highly’ unhelpful while a further 30% believed the government to be ‘fairly’ unhelpful (Figure 25a). Only 6% believed the government to be ‘highly’ or ‘very highly’ helpful. In aggregate, there appears to be little change between the 2007 and 2002 surveys on perceptions of the government-business relationship, although there have been changes within industry categories (Figure 25b). For instance, there appears to have been an improvement in such perceptions for the ‘mining and quarrying’ and ‘hotels and restaurants’ categories.

Figure 25a: Overall Relationship Perception between Government and Private Firms

Figure 25b: Overall Relationship Perception between Government and Private
Notes: The results give average scores by industry on a 6-point scale where 1 = very highly helpful, 2 = highly helpful, 3 = fairly helpful, 4 = fairly unhelpful, 5 = highly unhelpful and 6 = very highly unhelpful.

6.4 Question C3
Extent of Corruption and Impact on business

The first question in relation to corruption issues asked respondents to assess the impact on their businesses of instances of official corruption. A sizeable 40% of respondents reported that their businesses had been ‘highly’ to ‘very highly’ affected by official corruption, while only 10% reported they had been ‘highly’ or ‘completely’ unaffected (Figure 26a). While in aggregate there appears to have been little change between the 2007 and 2002 surveys, there have been some marked differences within industry categories. For instance, there appears to have been a significant increase in the impact of official corruption in the ‘other’ industry category and a slight increase in the ‘mining and quarrying’ category (Figure 26b).

Figure 26a: The Extent of Corruption in dealing with Government as being
Detrimental to Business

Note: The results give all the industries’ responses in terms of percentages.

Figure 26b: The Extent of Corruption in dealing with Government as being Detrimental to Business by a 6-point scale

Notes: The results give average scores by industry on a 6-point scale where 1 = completely unaffected, 2 = highly unaffected, 3 = fairly unaffected, 4 = fairly affected, 5 = highly affected and 6 = very highly affected

6.5 Question C4
Frequency of Irregular Payments to Officials

This question asked respondents to comment on whether it was common practice for firms in their respective sector to pay ‘irregular additional payments’ to government officials in order to ‘get things done’. While 16% of businesses responded that this practice ‘always’ occurred, 22% responded that the practice ‘never’ occurred (Figure 27a). The majority of businesses responded that the practice of irregular additional payments to officials ‘sometimes’ occurred. In aggregate there appears to have been little change in the response of businesses to this question between the 2007 and 2002 surveys. That said, and consistent with the previous question, ‘mining and quarrying’ and ‘other’ industry categories have reported an increase in the frequency of ‘irregular’ payments to officials (Figure 27b)

Figure 27a: Extent of Irregular Additional Payments to Government Officials for Services Rendered

Note: The results give all the industries’ responses in terms of percentages.

Figure 27b: Extent of Irregular Additional Payments to Government Officials for
6.6 Question C5
The Impact of Irregular additional Payments

This question was designed to see whether the payment of irregular additional payment by a firm led to the delivery of the service effectively as agreed, and without the request for further additional payments. Nearly a third of interviewed business did not respond to this question, either as it was irrelevant to them or for other reasons, leaving the remaining responses of limited utility.

Figure 28a: Extent to which Additional Corrupt Payments lead to “Positive” Outcomes

Note: The results give all the industries’ responses in terms of percentages.

Figure 28b: Extent to which Additional Corrupt Payments lead to Positive
**Outcomes by 6-point**

**Notes**: The results give average scores by industry on a 6-point scale where 1 = never, 2 = seldom, 3 = sometimes, 4 = frequently, 5 = mostly and 6 = always

### 6.7 [Question C6] Seeking Recourse from Corrupt Practices

This question asked respondents whether they felt that they were able to seek recourse from another government official or superior when they encountered corrupt or improper practices in their dealings with a government employee. Whilst, again, a large number of businesses did not respond to this question, 14% of businesses felt that they were ‘never’ able to seek recourse while 8% felt they were ‘always’ able to seek recourse (Figure 29a). Compared to the 2002 survey there appears to have been an increase in the number of businesses who felt they were able to seek recourse from another government official or superior when they encountered corrupt or improper practices (Figure 29b). This increase, however, is difficult to interpret. It may, for instance, reflect an increase in confidence that another government official will in fact act on their complaint. Alternatively, it may reflect an increase in frustration over the extent of corruption or improper practices with businesses increasingly seeking to have this situation redressed by raising the matter with other officials.

**Figure 29a**: Extent to which recourse can be sought when dealing with a corrupt
Government Official

Note: The results give all the industries’ responses in terms of percentages.

Figure 29b: Extent to which Recourse can be sought when faced by a corrupt Government Official by 6-point scale

Notes: The results give average scores by industry on a 6-point scale where 1 = never, 2 = seldom, 3 = sometimes, 4 = frequently, 5 = mostly and 6 = always

6.7 Government-Business Relations - Comment

The 2007 survey on government-business relations tends to confirm the view that due to government rules and regulations, and the actions of government officials (including in relation to corrupt or improper practices), PNG is a difficult place to operate a business. Many businesses operating in PNG already face considerable hurdles, such as very high
transport costs, a comparatively small and widely dispersed population (which serves to fragment commercial markets), law and order problems (section 5) and poor quality services and infrastructure (section 6). In this environment, businesses can ill afford cumbersome and overly restrictive rules and regulations. Nor can they afford unresponsive regulatory bodies. Rules and regulations impose costs on businesses (and, ultimately, on consumers) and it is therefore essential that they are only imposed when it is very clear that they are required to protect the national interest (eg, regulations to protect the natural environment).

Under the previous term of the Somare Government (2002-2007), the National Working Group on the Impediments to Business was formed to enable the private sector and government to reach a common view on the role and application of government rules and regulations. The Working Group was widely viewed as a successful forum and it not only led to the liberalisation of certain regulations, it also promoted a greater understanding between the government and the private sector. Unfortunately the Working Group has not met under the new government. Many in the private sector believe that the re-establishment of the Working Group is an essential step to improve government-business relations, and to restore the reform agenda for deregulation and liberalisation.

In discussing the impact of rules and regulations on businesses operating in PNG, additional comment should be made in relation to PNG’s resources sector. As noted, very high commodity prices have already stimulated strong economic growth in the PNG economy. If the proposed LNG plant proceeds, economic growth will accelerate in the years ahead. While the prospects for sustained and strong economic growth is good news, it also heightens the need for the government to ensure that its rules and regulations do not inhibit the economy’s flexibility. If, for example, the government maintains its restrictive regulations in relation to access to foreign labour, growth in the resources sector may well be at the expense of the other sectors in the economy that rely on skilled labour (eg, manufacturing and services).

If confronted with skilled labour shortages, resource companies will bid away such labour from other sectors in the PNG economy. In this instance, the growth in the resources sector would be contributing to the contraction of other sectors in the economy. This would constitute a classic ‘Dutch Disease’ phenomenon. To avoid such outcomes, rules and regulations should not inhibit the flexibility of the economy to adjust to a rapidly growing resources sector. Combined with an increased focus on expanding the number of skilled Papua New Guineans graduating from PNG’s tertiary and vocational institutions, a liberalisation of the rules and regulations governing the employment of foreign labour would enhance the flexibility of the economy and minimise adverse ‘Dutch Disease’ impacts.

While many in government continue to dispute claims of official corruption and improper practices, the 2007 survey tends to support PNG’s poor ranking in international surveys on corruption, such as Transparency International’s ‘Perceptions of Corruption’ Index. Official corruption can have pervasive and negative impacts on a country’s growth and
development. Official corruption not only imposes direct costs on legitimate businesses, it also creates an environment that promotes ‘rent seeking’ behaviour which is detrimental to the national interest.

In order to address businesses’ concerns over official corruption, the government should ensure that it’s key watch-dog and probity agencies are appropriately resourced (ie the Auditor-General and the Ombudsman Commission), and that the those involved in corruption are subject to the full force of the law. In addition, the government should also consider strengthening its anti-corruption legal framework, through, for example, the introduction of ‘whistle blowers’ protection legislation.

7. EFFECTIVENESS OF GOVERNMENT SERVICE PROVISION

7.1 Introduction

The quality of the operating environment for businesses is also dependent on the quality of supporting services and infrastructure, such as banking, telecommunications, electricity and roads. As in most other countries (developing and developed), in PNG supporting services and infrastructure are provided by both public sector (State Owned Enterprises) and private sector entities. Even when the services are provided by the private sector, government regulation can impact on the quality of the service provided.

Over the years, various economic reports by local and international agencies, and the 2002 and 1999 INA Private Sector Surveys, have all indicated that the quality of supporting services in PNG is poor. Moreover, this conclusion tends to apply across all services. Core infrastructure, notably roads and particularly rural access roads, are widely perceived as having deteriorated severely handicapping rural industries, or potential rural investment. For some services, such as electricity, water and sewerage, access is extremely limited. For example, an estimated 90 per cent of PNG’s population do not have access to electricity. As well, while businesses operating in PNG’s formal sector have access to electricity, reliability is poor, resulting in many having to rely on expensive back-up generators. The 2007 Private Sector Survey will allow an assessment of whether the effectiveness of supporting services has improved in recent years.

It is also important to note that upon being elected in 2002, the (Somare) Government effectively suspended the former Government’s privatisation program, and as an alternative, announced that it would place a greater emphasis on rehabilitating and revitalising State Owned Enterprises as a means of improving service delivery. This section of the survey will also allow an assessment of whether the services provided by State Owned Enterprises have improved under this policy approach.

7.2 Question D1
Overall perception of the efficiency, effectiveness and quality of selected services

This question is intended to provide an assessment of the private sector’s perceptions on the efficiency, effectiveness and quality of core supporting services. Respondents were requested to assess services according to a scale ranging from very good to very poor. Overall, ‘roads and bridges’ were ranked the poorest followed by ‘telecommunications and postal’ and ‘electricity’ (figure 30a). ‘Financial and banking services’ received the best ranking by respondents followed by ‘legal’ services and ‘port’ services (the latter two were ranked equally).

It is important to note that among the services surveyed, the best responses were recorded for those services provided overwhelmingly by the private sector, namely banking and legal services\(^\text{10}\). Since the effective privatisation of the state-owned Papua New Guinea Banking Corporation in 2001, banking and financial services are almost entirely provided by the private sector\(^\text{11}\), whilst legal services are wholly provided by the private sector.

Figure 30a: Overall Perception of the Efficiency, Effectiveness and Quality of certain Government Services

\(^{10}\) It is also important to note that while PNG Ports Incorporation Ltd is state owned, stevedoring is predominately undertaken by private companies.

\(^{11}\) To a limited degree, some financial services (lending) are provided by the state-owned National Development Bank
banking’ services the worst rating, whilst the ‘hotels/restaurants’ and ‘agriculture/fisheries/forestry’ sectors gave the best rating (figure 30b). The ‘building/construction’, ‘finance/investment’ and ‘other sectors gave ‘legal’ services the best rating (figure 30c). Unfortunately these services were not included in the 2002 survey, so no intra-survey comparison can be made.

**Figure 30b:** Overall Perception of the Efficiency, Effectiveness and Quality of Financial and Banking Services

<table>
<thead>
<tr>
<th>Sector</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture/forestry</td>
<td>4.1</td>
</tr>
<tr>
<td>Building/construction</td>
<td>4.2</td>
</tr>
<tr>
<td>Finance/investment</td>
<td>4.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>4.4</td>
</tr>
<tr>
<td>Mining/processing</td>
<td>4.5</td>
</tr>
<tr>
<td>Retail/wholesale</td>
<td>4.6</td>
</tr>
<tr>
<td>Transport/communication</td>
<td>4.7</td>
</tr>
<tr>
<td>Utilities</td>
<td>4.8</td>
</tr>
<tr>
<td>Total</td>
<td>4.9</td>
</tr>
</tbody>
</table>

**Figure 30c:** Overall Perception of the Efficiency, Effectiveness and Quality of Legal Services

<table>
<thead>
<tr>
<th>Sector</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture/forestry</td>
<td>3.0</td>
</tr>
<tr>
<td>Building/construction</td>
<td>3.1</td>
</tr>
<tr>
<td>Finance/investment</td>
<td>3.2</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3.3</td>
</tr>
<tr>
<td>Mining/processing</td>
<td>3.4</td>
</tr>
<tr>
<td>Retail/wholesale</td>
<td>3.5</td>
</tr>
<tr>
<td>Transport/communication</td>
<td>3.6</td>
</tr>
<tr>
<td>Utilities</td>
<td>3.7</td>
</tr>
<tr>
<td>Total</td>
<td>3.8</td>
</tr>
</tbody>
</table>

For ‘port’ services, the worst ratings were given by the ‘building and construction’,
‘hotels’ and ‘manufacturing’ (figure 30d). For ‘water and sewerage’ services, the worst rating was awarded by the ‘hotels and restaurants’, ‘mining and quarrying’ sector, followed by the ‘retail and wholesale’ sector (figure 30e). Unfortunately these services were not included in the 2002 survey, so no intra-survey comparison can be made.

Figure 30d: Overall Perception of the Efficiency, Effectiveness and Quality of Port Services

![Overall Perception of the Efficiency, Effectiveness and Quality of Port Services](image)

Figure 30e: Overall Perception of the Efficiency, Effectiveness and Quality of Water and Sewerage Services

![Overall Perception of the Efficiency, Effectiveness and Quality of Water and Sewerage Services](image)

As noted above, taken as a whole, respondents rated the efficiency, effectiveness and
quality of road and bridges poorly, and the worst among all services surveyed. This will come as no surprise to observers of PNG, as the poor state of PNG’s land transport infrastructure is regularly cited as one of the most serious constraints for economic growth and development. Across industry categories, ‘road and bridges’ received the worst rating by the ‘other’ sector, followed by the ‘retail/wholesale’ and ‘manufacturing’ sectors (figure 30f). For ‘roads and bridges’, a comparison can be made between the 2007 and 2002 private sector surveys. The data presented in figure 30f, indicates that for the private sector as a whole, there may have been a very modest improvement in perceptions over the quality of roads and bridges, but the sample is not identical and this would probably only apply to main roads. That said, respondents clearly remain very concerned over the quality of the land transport network and its impact on private sector development.

Figure 30f: Overall Perception of the Efficiency, Effectiveness and Overall Quality of Road and Infrastructure Services

Taken as a whole, the quality of ‘telecommunications and postal services’ received the second worst rating by respondents. Across industry groups, ‘telecommunications and postal’ services received the worst rating by the ‘mining and quarrying’ sector, followed by the ‘building and construction’ and ‘agriculture’ sectors (figure 30g). For ‘telecommunications and postal’ services a comparison can be made with the 2002 survey. On the basis of the aggregate data, there does not appear to be any significant improvement in the private sector’s perceptions over the quality of these services. Importantly, it is noted that this survey was conducted prior to the commencement of operations in PNG of a private mobile telephony company (see section 7.5 below).

Figure 30g: Overall Perception of the Efficiency, Effectiveness and Quality of

\[12\] Telecommunications and postal services were combined in the 2002 and 2007 surveys. It is possible that the negative impression of telecommunications as a serious handicap to business and investment is not extended to postal services, which anecdotal evidence suggests may have improved over recent years.
Telecommunications and Postal Services

Across industry categories, the quality of electricity services received the worst ratings by the ‘other’, ‘transport and communications’ and ‘manufacturing’ sectors (figure 30h). Compared to the 2002 survey, there appears to have been some improvement in the private sector’s perceptions over the quality of electricity services. That said, the overall rating is still fairly poor to poor, suggesting that electricity services are still viewed as a constraint to private sector development.

Figure 30h: Overall Perception of the Efficiency, Effectiveness and Quality of Electricity Services

[Question D2]
Overall Rating for Government Services

In this question businesses were asked to provide their overall rating of the efficiency, effectiveness and quality of government services in general. The substantial majority of respondents rated government services as ‘fairly poor’ (42 %), followed by ‘very poor’ (22 %) and ‘poor’ (19 %). Only 15 % of respondents rated government services as ‘fairly high’, while the ratings for ‘high’ and ‘very high’ were negligible (figure 31a). Compared to the 2002 private sector survey, there appears to have been some improvement in the overall perceptions of government services, with the most significant improvement being recorded by the ‘transport and communications’ sector (figure 31b). Nonetheless, the 2007 survey indicates that businesses still view the quality of government services with concern and thereby an ongoing constraint to private sector development.

Figure 31a: General Rating of the Efficiency, Effectiveness and Quality of Government Service Provision

Note: The results give all the industries’ responses in terms of percentages.

Figure 31b: General Rating of the Efficiency, Effectiveness and Quality of
7.3 [Question D3]

Improvement in the quality of government services through major reforms

This question sought to determine whether businesses agreed with the view that major reforms would lead to an improvement in the quality of government services. Not surprisingly, the substantial majority of respondents (70%) ‘strongly agreed’ or ‘agreed’ that major reforms would improve the quality of government services (figure 32). Only 8% disagreed with this premise.

Figure 32: Business View of the Need for Major Reforms for Improvement of the Quality of Government Services

Note: The results give all the industries’ responses in terms of percentages.

7.5 Effectiveness of Government Service Provision - Comment
The 2007 private sector survey confirms that businesses remain very concerned about the quality of supporting services. Poor supporting services increases the costs of doing business and thereby inhibits private sector expansion and, hence, economic growth. One noteworthy result of the survey is that those services predominately provided by the private sector, notably banking and legal services, were given the best ratings. This is hardly surprising given the weight of international evidence on the superior performance of private sector enterprises in delivering commercial services. The clear lesson here is that government should not be involved in the delivery of services that are best provided by the private sector.

In relation to telecommunications, it is important to note that in 2007 (but after the survey was conducted), a private mobile telephony company established operations in PNG, and it has impact substantially on the performance of the sector. It has underpinned the expansion on mobile phone services to such an extent that the Department of Treasury has estimated that the ‘transport, storage and communications’ sector of the PNG economy grew by 35 per cent in real terms in 2007, and contributed 0.7 percentage points to overall real GDP growth of 6.2 per cent. In addition, the message from a number of public forums and seminars held recently in PNG is that the private mobile telephony company has overwhelming support from the business and wider community.

Notwithstanding the above, it appears that the government remains ambivalent to the role of private sector competition in telecommunications. Under the government’s revised Information and Communications Technology (ICT) policy, which was released in early 2008, the state-owned teleco (Telikom PNG Ltd) was granted exclusive rights to operate an international gateway (thereby removing the right of the private company to operate its own gateway). As well, while the ICT policy commits the government to ‘phased competition’, there is no firm timetable for open competition. The policy suggests that open competition will not be introduced until Telikom is reformed and revitalized, in order to enable it to compete in an open market. It is important to appreciate that the need to reform and revitalise State Owned Enterprises, such as Telikom, has been a policy objective of the government since 2002.

As noted, upon being elected in 2002, the government effectively suspended the former government’s privatisation program and announced its policy to revitalise and rehabilitate state-owned enterprises as a central means to improve service delivery. The 2007 private sector survey suggests that this new policy approach has, at best, met with very limited success. For instance, and as noted above, in respect of telecommunications and postal services, there has been no significant change in the private sector’s perceptions in the 2007 survey compared to that undertaken in 2002; (the two services were combined in the survey and there are suggestions that views towards postal services are more positive than towards telecommunications). In respect of electricity services, the 2007 survey suggests there has only been a marginal improvement since 2002, and overall, private sector perceptions of the quality of the service remain poor.

Public-Private Partnerships have had a mixed track record in PNG, and were specified as
a priority of the new Government from 2002, but with little subsequent action. In mid-2008 the Government entered into a Memorandum of Understanding (MOU) with the Asian Development Bank to develop a Public-Private Partnership policy to improve service delivery\(^{13}\). This policy is expected to be developed over the course of 2008 and, as such, it is too early to assess whether this new approach will lead to a much needed improvement in the quality of core services.

8. HINDRANCES TO BUSINESS AND INVESTMENT

8.1 Introduction

The final section of the 2007 Private Sector Survey provided businesses with the opportunity to rank a range issues according to the impact on their respective operations and future investment decisions. This section of the survey also requested that respondents nominate the top three priority issues for the government to address in order to improve the environment for business and investment.

[Question E1]

Ranking of hindrance to business and investment

This question requested respondents to rank twenty two commonly cited issues according to the impact on the respondents’ respective businesses, in terms of both current operations and future investment decisions. The ranking was according to a 6 point scale, ranging from ‘not a problem’ to ‘extremely problematic’. Consistent with the results of the earlier survey questions, respondents reported that the greatest hindrances to business were posed by ‘law and order’, ‘corruption’ and political uncertainty’ (figure 33a). The state of core supporting services such as telecommunications, transport infrastructure and electricity also rated highly as a hindrance to business.

Figure 33a also indicates the issues that posed the greatest hindrance to business in the 2007 survey were also nominated as significant hindrances in the 2002 survey. Comparing the two survey periods, land issues (‘access to land’ and ‘land compensation claims’) have been rated as a greater hindrance to business and investment in 2007 compared to the 2002 survey. In contrast, the hindrance posed by the key macroeconomic variables of interest rates, inflation and exchange rate variability eased significantly in the 2007 survey compared to that reported in 2002. This outcome is to be expected given the significantly improved macroeconomic environment in 2007 compared to 2002.

\(^{13}\) It is noted that the government first announced its commitment to the Public-Private Partnership approach in 2003.
Figure 33a: Ranking of hindrances to the Business and Investment Climate in PNG.
8.2  [Question E2]  
Top three priority areas for government reform.

The final question in the 2007 survey requested respondents to nominate the top three priority issues for the government to address in order to encourage business and investment. The results from this question are consistent with the concerns expressed by business in the overall survey. A substantial 39.2% of respondents nominated ‘law and order’ as the most important issue for the government to address (figure 34a). Fifteen percent of respondents nominated ‘corruption’ as the most important issue while 8.8 percent nominated ‘transport infrastructure’. ‘Law and order’ and ‘corruption’ were also nominated as the most important issues to address in the 2002 survey. Compared to the 2002 survey, there was a significant increase in the percentage of respondents nominating ‘telecommunications’ as the most important issue for government, while there was significant decline in the percentage nominating ‘exchange rate variability’ and ‘political uncertainty’ as the most important issues.
Figure 34a: Businesses view of the most important issue for the government to address in order to encourage business and investment.
Ranked in ascending order by 2007 priority

Figure 34b: 1st Priority for Government to Tackle to Encourage Business and Investment

Figure 35: Businesses view of the Second most important issue for the Government to address in order to encourage Business and Investment
Figure 36: Business view of 3rd Priority Issues for the Government to tackle in order to Encourage Business and Investment
9. SUMMARY AND CONCLUSION

In the foregoing report we carefully analyzed and presented the key findings of the 2007 Private Sector Survey with series of accompanying policy issues emanating primarily from the findings.

The following six broad headings reflect the content of the entire report.

i. Basic information about businesses operating in PNG;
ii. Government regulations and policies;
iii. Business security;
iv. Government business relationship;
v. Effectiveness of government service provision; and Rating hindrances to business and investment.

The key findings, trends and policy issues that have emerged from our discussion in the main text of this report are summarised at the outset under the Executive Summary: Key Findings and Policy Issues, which forms an important part of this report.
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