

Papua New Guinea: Continuing to Muddle Through



Jenny HAYWARD-JONES

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Executive summary

Papua New Guinea (PNG), a country of approximately 8 million people in the South Pacific, is one of the most resource-rich countries in the world, but successive governments have failed to put the country on a stable development track.

The instability that characterized democracy in PNG for 25 years after independence in 1975 has evolved into a more predictable, but also more powerful central government. The recently re-elected government of Prime Minister Peter O'Neill will continue to control members of parliament through the allocation of valuable constituency development funds. These funds place the onus of essential service delivery on individual members of parliament but lack the transparency and accountability measures to which national institutions are obliged to adhere.

After a decade of economic growth, peaking at a high of 13.3 percent in 2014, PNG's economy has slowed, revenue has collapsed and the government is facing a severe budgetary crisis. PNG will host the APEC Leaders' Summit in 2018 as it implements dramatic cuts in expenditure for health and education. The government's plans to increase revenue are unlikely to come to fruition and it lacks the will to take measures such as allowing currency depreciation or reducing the cost of constituency development funds that could stimulate growth and limit further pressure on the budget.

What limited progress that has been made in raising the living standards of the majority of the population is now being threatened by declines in funding for hospitals, rural clinics and all levels of schooling. Ambitious government policies to deliver free education and health services have not succeeded in raising the quality of education or delivering more health care. Poor governance, including corruption and a lack of capacity in public services, acts as a further constraint on social development.

Although it faces significant internal security challenges such as high levels of crime and violence, firearms trade and violence against women and children, PNG faces a relatively benign external threat environment. But like many countries, PNG is grappling with how it should deal with the growing influence of China. China is an increasingly important trading partner and investor, with new infrastructure investments in PNG being made under the One Belt, One Road initiative. Australia remains PNG's most important

strategic partner, but Australia's current dominance in investment, trade and aid in PNG cannot be taken for granted. The recent controversy associated with Australia's detention of asylum seekers in the province of Manus has highlighted some of the strains in Australia-PNG relations caused by Australia's punitive approach to dealing with asylum seekers. Australia's 2016 Defence White Paper and 2017 Foreign Policy White Paper prioritize the importance of a stable and prosperous PNG and promise continuing deep engagement with Australia's nearest neighbor. But China's willingness to ask a price for its commitment to PNG and the potential for growth in that commitment will challenge PNG's loyalties.

PNG's population has a long tradition of resilience and self-sufficiency and the state frequently finds a way to "muddle through" each seeming disaster that strikes the nation. But in a rapidly changing world, there is no certainty that PNG can continue to muddle through without creating much more serious problems for the next generation of its leaders to manage.

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Introduction

Papua New Guinea is known as the “land of the unexpected”. It is a country of some 8 million people and approximately 850 languages. It is one of the most resource-rich countries in the world, but 40 percent of the population are thought to live in poverty. A decade of economic growth fueled by a resources boom helped to drive infrastructure development in the capital, Port Moresby, but delivered little to the 85 percent of the population living outside the capital.

The political leadership of the country was plagued by instability until the late 1990s, but the greater stability and certainty that has evolved since then has also brought a more authoritarian style of national leadership. It has also seen an erosion of the parliament’s vital role in providing a check and balance on the government. Prime Minister Peter O’Neill wields considerable power, wrought not by legal statute, but rather by his ability to crowd out any opposition. Policy decisions such as the introduction of tuition fee-free education, free healthcare, the building of new universities, and offering to host the APEC Leaders’ Summit in 2018 bore the mark of a confident leader of a booming economy, but policy implementation has been poor, diminishing confidence in the government’s ability to deliver on its social contract with its population. With the end of the resources boom and the subsequent budget crisis it has induced, business confidence in the O’Neill government’s economic management is waning.

There are reasons to be both optimistic and pessimistic about PNG’s future. PNG has an abundance of valuable resources that remain in global demand, sufficient arable land and agricultural skills to enable the population to feed itself, and an overwhelmingly young population. In the 42 years since independence, however, progress in raising the living standards of the population has been extremely slow and, despite impressive economic growth over the last decade, is now faltering. Current trends in the economy, health, education and law and order do not augur well for the future. But the country also has a history of “muddling through” and managing to avoid predicted catastrophes, so there would seem to be limited practical value to anticipating disaster for PNG even when all the signals are negative.

Making judgements about PNG's trajectory is notoriously difficult. There is a severe paucity of reliable data on almost everything in PNG. The poor quality of the latest census means our assumptions about demographics are more than a decade out of date. The lack of good data on education and health hinders not only public understanding but the government's ability to make crucial planning decisions. There are so many complex development challenges facing the nation that are of equal priority and appear to be equally impossible to resolve. It is not easy to identify what elements of the state are likely to succeed or fail when the majority of the population have never experienced the benefits of a functioning state. What is certain, however, is that PNG is not on a stable development trajectory now.

This paper will consider the immediate and future political, economic, social and security challenges for PNG and suggest how these might be managed by the nation's leadership.

Papua New Guinea



Source: Perry Castañeda Library Map Collection, University of Texas.

Politics: centralizing power, decentralizing responsibility

PNG is a constitutional democracy with a Westminster parliamentary system inherited from its colonial master, Australia, when it became an independent state in 1975. National elections are held every five years. The terrain of the country makes it impossible to hold elections on a single day. PNG's capital, Port Moresby, is not connected to any other major population center in the country by road. Ballot papers and boxes are distributed around the country via small vessels, small aircraft and through the Highlands region, by truck on the Highlands Highway. Elections are held over the period of two weeks to ensure PNG's poorly resourced Electoral Commission can distribute ballot boxes to polling stations across the country and staff polling stations on the required days. Candidates for elections, whether they stand as independents or as representatives of a party, need to have large endowments of cash to run a campaign. Elections have been typically accompanied by violence in several centers – during the voting process, the counting process and after winning candidates have been declared – inspired by disagreements between supporters of different candidates, frustration with names not being on the electoral roll, disputes over eligibility of candidates and disputes over the eventual declared winners.

From political instability to a strong centralization of power

From 1975 until the early 2000s, politics in PNG was inherently unstable. No one party had ever been able to form a majority in its own right, compelling the formation of coalitions following elections. Leaders were deposed regularly in motions of no-confidence and party-swapping was common. The political culture in PNG has created an expectation, particularly in the densely populated Highlands constituencies, that successful candidates for elections deliver (goods, services and cash) in order of priority (1) to their tribe, clan or “wantoks” – their extended family and community which helped them get elected; (2) to their district; (3) to their province; (4) to their party; and (5) to the nation.¹ In practice, members

1. “Voters in Papua New Guinea Head to the Polls: Loyalty to the Clan Impedes Party Politics”, *The Economist*, 1st July 2017, www.economist.com.

of parliament are highly motivated to win ministerial positions that give them the greatest capacity to direct the state to deliver better services and infrastructure to their constituents or to access the funds to do it themselves.

In 2003, the Organic Law on the Integrity of Political Parties and Candidates was enacted, making it much more difficult to remove a Prime Minister in a motion of no-confidence and constraining members of parliament from swapping parties. The law – known as OLIPPAC – was introduced a year after the introduction of limited preferential voting (which itself has been blamed for the proliferation of money politics).² Although it was later found to be unconstitutional, OLIPPAC was credited with bringing political stability to PNG, with only two leaders, Sir Michael Somare and then Peter O’Neill, occupying the Prime Minister’s office since that time. But this stability has come at a price. The Prime Minister, now more secure in office, wields more power than ever before and has centralized much decision-making in his office.

When Prime Minister Peter O’Neill first took office as Prime Minister in 2011, he was heralded by his fellow members of parliament and by the business community as a reformer, an honest broker and a leader who could get things done, after years of the relative inactivity and indecisiveness of the Somare government. Although the manner of his ascension to the Prime Minister’s office was controversial and triggered a constitutional crisis, O’Neill was widely regarded as the preferred Prime Minister.³ O’Neill was fortunate to come to power as the resources boom was underway. He wielded deals with resources companies and attracted investment that saw rapid infrastructure development in the capital Port Moresby (but not the rest of the country). He sought to be more active on the world stage – travelling and hosting visits by prominent Asian leaders and hosting the Pacific Islands Leaders’ Forum in 2015 – and more pro-active at home. While GDP growth was high – rising to an all-time high of 13.3 percent in 2014 – and infrastructure development in the capital visible, O’Neill had a reputation as a leader who got things done.⁴ This reputation began to falter when the world price for LNG and other resources fell and when O’Neill himself was investigated for corruption.

Prime Minister O’Neill was extremely effective not only in centralizing power in his office but also in minimizing his opposition. He did this by prioritizing access to the valuable District Services Improvement Funds and

2. N. Haley and K. Zubrinich, “Assessing the Shift to Limited Preferential Voting in Papua New Guinea: Money Politics”, *DevPolicy Blog*, 15 September 2015, <http://devpolicy.org>.

3. “PNG in ‘Unprecedented Constitutional Crisis’”, SBS, 14 December 2011, www.sbs.com.au.

4. *Asian Development Outlook 2016: Asia’s Potential Growth*, Manila, Asian Development Bank, 2016, www.adb.org.

Provincial Services Improvement Funds to members of parliament who aligned with the government ahead of the opposition members of parliament. These funds were first introduced to enable members of parliament to fund services or infrastructure development in their districts and have become crucial to members of parliament seeking re-election, thus inducing members of the opposition to join the government. For much of the term of the previous parliament, 106 members of the 111-member house sat on the government benches and, although the five members of the opposition fought hard to have a voice, the infrequent sittings of parliament meant the public rarely heard any parliamentary opposition to government policies and actions. Some public critics – in academia, the legal fraternity and in the media – of the Prime Minister’s policies – have been isolated; sacked from their jobs, refused entry to press conferences; refused interviews; threatened with legal action; or not granted an entry visa if they were foreign citizens. While this has not stopped prominent critics from speaking out, the general intolerance of criticism from the Prime Minister’s office point to unfortunate anti-democratic tendencies.

The rise of an opposition?

General elections in June 2017 saw the re-election of a government led by Prime Minister Peter O’Neill but were marred by widespread problems with the electoral roll, violence in some locations and long delays in counting. Thousands of voters were advised by election officials that they were not on the roll when they arrived at polling stations to cast their vote. Violent disputes erupted at a number of polling stations, particularly in the Highlands region. Ballot boxes were destroyed by scrutineers in several centers. All three members of the Electoral Advisory Council resigned the day after voting concluded in protest that the Electoral Commission was making it impossible for them to do their job.

International election observers concluded that despite significant flaws, the results of the election reflected the will of the people. Some critics were suspicious that Prime Minister Peter O’Neill had interfered in the electoral process, a sentiment enhanced by the disappearance of some of O’Neill’s most prominent opponents, including former Prime Minister Sir Mekere Morauta, from the electoral roll. However, the loss of seats of prominent members of O’Neill’s People’s National Congress (PNC) party to the surging opposition party, PANGU (Papua and Niugini Union), would suggest that O’Neill’s ability to influence the electoral process was limited. Although the flaws in the elections were no doubt in part caused by chronic under-funding of the Electoral Commission, there were other contributing factors. And although O’Neill was successful in forming a government, the

election results, combined with strong criticism expressed on social media by vocal members of an emerging middle class, showed that there is significant voter opposition to his leadership and his party and an appetite for an alternative government and style of leadership.

No women were elected to the national parliament in the 2017 elections. This is the first time this has happened in 25 years, but not the first time in PNG's history. The result is especially disappointing as a record number of women candidates (167 out of 3332 total candidates) stood for election this year.⁵ The government will be under greater pressure now to consider special measures to ensure women have a voice in this parliament and guaranteed seats in the next parliament.

There were early hopes that a viable opposition may have emerged from this election when a group of members of parliament known as "The Alliance" took a determined stand against the O'Neill government. These hopes have since been dashed somewhat when a faction from the Alliance was persuaded to join the O'Neill government. Sam Basil, the popular leader of the PANGU party, was much admired as a courageous leader of the Alliance standing up to Peter O'Neill's dominance, but has since accepted a position in O'Neill's cabinet. He disappointed his supporters but said he could only deliver to his constituency if he was part of the government. Basil's early defection to the government suggests that Prime Minister O'Neill's capacity to continue to weaken the legislature in his favor will endure in this parliament as it did in the last. And if the opposition in this parliament is as systematically weakened as it was in the last, it will be up to the public – non-government organizations, prominent members of the emerging middle class and local businesses – to hold the government to account.

The history of PNG's parliament in recent years would suggest that not enough members of parliament are motivated by a desire to grow the fortunes of the nation and its population ahead of the fortunes of either themselves, their clan or their districts. In practical terms though, members of parliament are under enormous pressure to personally deliver to their electorates. As long as the expectation from voters is on their local member of parliament rather than the state to deliver services, members of parliament will have to prioritize the needs of their constituents above the needs of the nation. The results of the elections revealed more schisms in voting along regional lines than had previously been the case in PNG, suggesting there will continue to be pressure put upon members of

5. *Outcome Statement: Forum on Women Candidates' Participation in the 2017 PNG Election*, United Nations Development Program, 21 August 2017. www.pg.undp.org.

parliament to improve the lot of their own regions. It is too early to tell what sort of impact this trend might have on national politics, but in an environment where some provinces are already clamoring for greater autonomy from Port Moresby and ahead of a mandated referendum on Bougainville's future political status, it is a worrying development.

From resource-driven economic boom to budgetary crisis

Reliance on extractive industries...

From the mid-2000s until 2016, PNG enjoyed relatively strong economic growth driven by high global demand for PNG's resources. In 2015, PNG had the fastest growing economy in the world, thanks largely to LNG shipments from ExxonMobil's US\$19 billion investment in PNG LNG. That stunning success has since been reversed and the PNG government is now dealing with the consequences of failing to manage earlier growth and unfortunate investment decisions.

Low world prices for oil and gas saw the contraction of these industries in PNG, contributing to a 10 percentage point fall in the GDP growth rate to just 2 percent in 2016. GDP growth is forecast to remain around this level for some years. Foreign investment has also been in decline since 2014. Although an 11.5 percent drop in net foreign assets in 2016 was largely due to LNG project construction coming to an end, government policies did not help. Revenue from large resource projects has declined significantly. Government borrowing is currently at record levels.

PNG's central bank, the Bank of PNG, imposed control mechanisms on foreign exchange leaving PNG in 2015 and maintains these to the consternation of small to medium businesses. The controls were introduced in response to a depreciating kina and the decline in foreign exchange coming into the country. The decline in commodity prices and lower investment in PNG and the consequent decline in exports have led to an ongoing foreign exchange shortage.⁶

At the admission of PNG's Treasurer, Charles Abel, the economy is overly reliant on the extractives industry, global commodity prices for exports, and on imports of food and fuel.⁷ The under-utilized non-mining sector (namely agriculture, forestry and fisheries), contributes about 20 percent of PNG's economic output but was arguably in decline in 2017.

6. D. James, "Top Bankers Set the Record Straight on Papua New Guinea's Foreign Exchange Shortage", *Business Advantage International*, 31 August 2016, www.businessadvantagepng.com.

7. F. Mou, "Government to Reduce PSIP and DSIP Funds", *Loop PNG*, 29 August 2017, www.looppng.com.

The impact of the El Nino drought in 2015-2016, combined with low oil and gas prices, have seen dramatic declines in government revenues and increases in operating costs for the government. Macro-economic shifts such as world prices for PNG's most valuable exports are beyond the control of the government but with PNG's previous experience of the boom-bust nature of its economy, it is a pity the government did not better manage volatility in revenue and expenditure.

... with serious budgetary implications

The major consequence of volatility in revenue is that the level of government expenditure is unpredictable from one year to the next, which constrains the government's ability to plan effectively for service delivery and infrastructure development. PNG has yet to enact the legislation to establish a Sovereign Wealth Fund to enable it to better manage volatility, although it has operated various other special purpose funding mechanisms.

PNG's National Budget forecasts growth of 2.2 percent in 2017 and 2.4 percent in 2018. The 2017 forecast reflects the "contraction associated with the natural decline in PNG's major oil fields, low production and export of logs in the forestry sector" which have "offset the increases to gold, nickel and cobalt production from major mines and additional gas production from the LNG plant".⁸

PNG's new Treasurer, Charles Abel, was Minister for Planning in the previous government. He is widely regarded as one of the most competent and credible ministers in Prime Minister Peter O'Neill's cabinet, but his inclination for bold actions appears likely to be constrained by the Prime Minister's desire to avoid alienating his allies in parliament.

In delivering the 2018 budget, Abel was refreshingly frank about the weakness of the PNG economy after "it endured a series of economic shocks" and acknowledged that the government was facing a revenue crisis. Government revenue represents 13 percent of GDP, below the long-term average of 30 percent.⁹ The reasons behind the collapse of revenue are varied and include the poor capacity of revenue collection agencies, asset depreciation of the newer major resource projects, revenue streams that are channeled through state-owned enterprises, and tax and compliance avoidance.¹⁰

8. "2018 National Budget: Vol.1 Economic and Development Policies", PNG Department of Treasury, www.treasury.gov.pg.

9. J. Pryke, "No Course Correction in PNG Budget", *Lowy Interpreter*, 30 November 2017, www.lowyinstitute.org.

10. *Ibid.*

The IMF, in concluding its Article IV Consultation with PNG in December 2017, warned that “on unchanged fiscal and monetary policies, PNG faces several more years of economic stagnation, with a growing risk of fiscal and financial instability as the debt-to-GDP ratio continues to rise and financing of deficits becomes increasingly difficult”.¹¹ IMF Directors have advised that “fiscal consolidation should involve expenditure measures including streamlining public sector employment and payroll as well as prioritizing spending on education, health care and infrastructure” and stressed that the “implementation of a medium-term strategy to increase revenues is also important to support higher and more inclusive growth”.¹²

Economists are skeptical of the Treasurer’s promises to increase revenues, given the PNG government’s past failures.¹³ A further attempt at a sovereign bond issuance and negotiating budget support from the World Bank and Asian Development Bank is unlikely to compensate for the government’s 2018 expenditure commitments. The government has promised to maintain key policies including Tuition Fee-Free Education, Free Primary Health Care, constituency improvement funds (after earlier promises to reduce the cost of these) and APEC 2018 preparations. It is also reallocating funds to cover urgent expenditure in areas such as pharmaceutical drugs, debt service and the Department of Works.

The other major problem for the Treasurer is that there appears to be an emerging recession in the non-resource economy.¹⁴ PNG could begin to avert this by importing more machinery and equipment to stimulate growth, but instead has seen imports in this category fall by 58 percent since 2010.¹⁵

11. “Papua New Guinea 2017 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for Papua New Guinea”, International Monetary Fund, December 2017, www.imf.org.

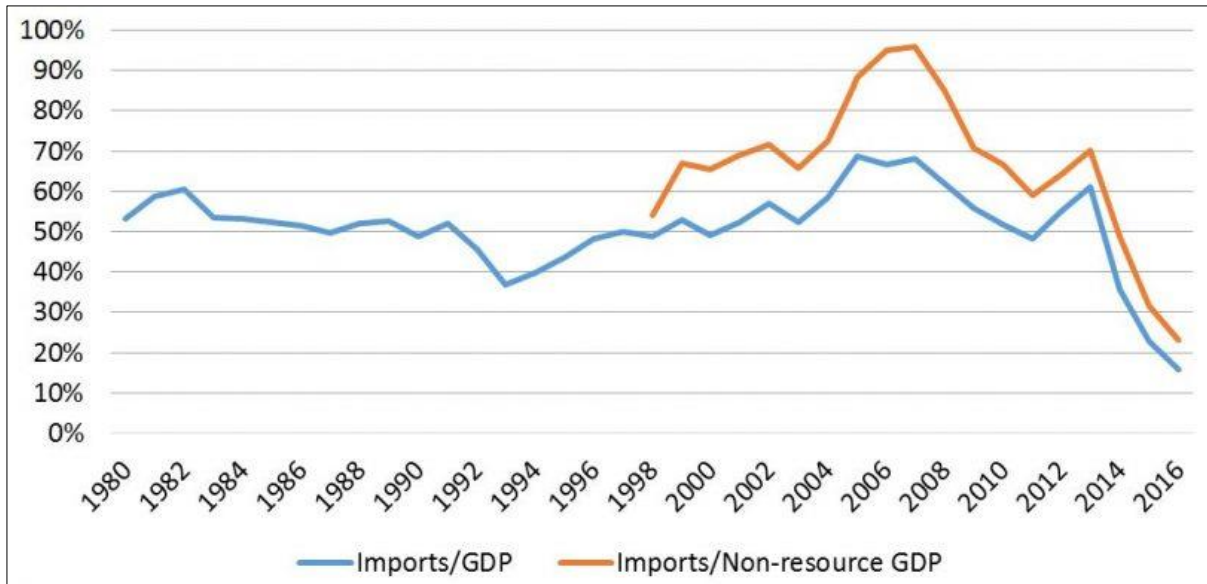
12. *Ibid.*

13. P. Flanagan, “2018 Budget: Nice Words, Poor Numbers”, *PNG Economics*, November 2017, <http://pngconomics.org>.

14. S. Howes, “Papua New Guinea 2018 Budget Fails to Solve Revenue Crisis”, *DevPolicy Blog*, 29 November 2017, <http://devpolicy.org>.

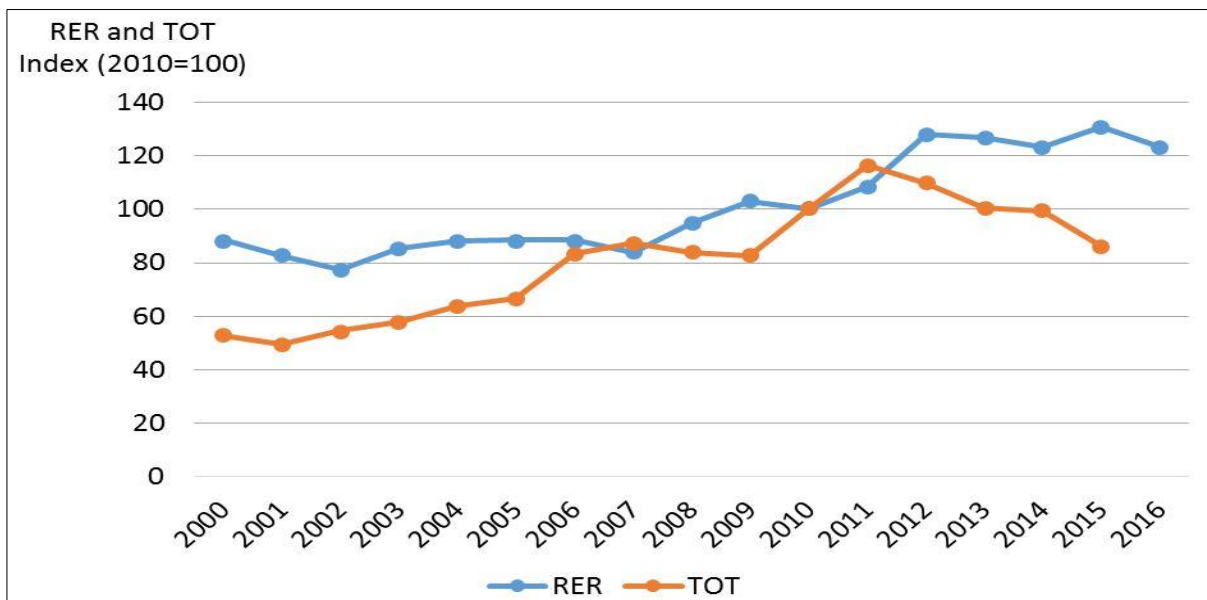
15. *Ibid.*

Imports as a percentage of GDP and non-resource GDP



Source: WDI and BPNG.¹⁶

PNG's real exchange rate (RER) and terms of trade (TOT)



Source: World Development Indicators (WDI).¹⁷

16. R. Fox, S. Howes, N. A. Nema, and M. Schroder, "Foreign Exchange Restrictions in PNG: Costs and Remedies", *DevPolicy Blog*, 22 September 2017, <http://devpolicy.org>.

17. *Ibid.*

The Australian National University's Stephen Howes argues the best thing PNG could do to stimulate economic growth and thereby boost revenues as well as jobs, would be to let the currency depreciate, which would, over time, reduce the need for foreign exchange rationing and stimulate exports.¹⁸

The Government's failure to act decisively on expenditure cuts – particularly to the costly (and discretionary) constituency development funds – or on credible revenue-raising measures do not bode well for 2018.

Potential for growth in agriculture and small business

The formal sector (e.g. resources, banking, accounting) accounts for 15 percent of PNG's economy; the other 85 percent consists of an "informal", largely subsistence sector. This sector provides informal employment opportunities to the majority of the rural population, provides food for the majority of the population and provides a significant safety net for the welfare of the people that the government would never be able to support. But the sector lacks adequate government support. There is, however, increasing awareness of the value of investing in the nation's agricultural sector. In November 2017, Prime Minister O'Neill announced measures to strengthen the agriculture and SME sectors by increasing access to long-term credit and trialing a National Plantation Management Agency.¹⁹ The 2018 National Budget contains a PGK100 million allocation for a dedicated SME fund for concessional lending and a PGK100 million allocation for an agricultural commercialization fund.²⁰

While a substantial increase in major corporate investments over the medium to long-term in PNG would be very welcome and is not impossible, formal sector growth will also need to be driven by the development of domestic small to medium enterprises. The World Bank's Doing Business Survey for 2017 ranks PNG at 130 out of 190 countries for ease of starting a business.²¹ Young entrepreneurs report serious obstacles including difficulties of raising capital, the high cost of renting business premises in urban areas, high utility costs, poor and expensive internet access, lack of access to infrastructure in rural areas, lack of safety, and difficulties in sourcing business inputs from overseas. If the government is serious about

18. *Ibid.*

19. "O'Neill Plans New Initiatives to Promote Agriculture in Papua New Guinea", EMTV, 27 November 2017, www.emtv.com.pg.

20. "2018 National Budget: Vol.1 Economic and Development Policies", *op. cit.*

21. *Doing Business 2017: An Equal Opportunity for All. A World Bank Group Flagship Report*, World Bank, 2017, www.doingbusiness.org.

reducing its over-reliance on the extractives industry, it should address obstacles to the development of domestic enterprise.

Struggling to make progress in health and education

Progress in raising the living standards of the majority of the population in PNG has been extremely slow and is arguably faltering. Although the national government's failings in delivering development outcomes to the rural majority are many, its weaknesses in delivering health and education services have been particularly harmful. It is worth noting, however, that service delivery in PNG is extremely challenging. Even a rich country would struggle with the kind of obstacles the PNG government faces in such a difficult geographical terrain. Transport infrastructure is weak and poorly maintained, making the transport of essentials such as pharmaceuticals and school materials difficult. Costs are high across the board, including, crucially in electricity, which is scarce across the country. Recruiting health and education sector professionals to serve in remote, rural areas is an ongoing challenge given limitations to public service pay scales.

Failing health

PNG has major health challenges. The top five causes of morbidity and mortality include diseases associated with the country's climate and environment such as malarial and diarrheal and waterborne diseases, but also include vaccine preventable diseases such as tuberculosis, a disease which is now present in parts of PNG as the multi-drug resistant variety. Immunization rates are below World Health Organization standards. Approximately 30,000 people live with HIV in PNG. The maternal mortality rate is very high at 230 per 100,000 live births.

The number of people affected by non-communicable diseases, including cardiovascular and respiratory disease, cancer and diabetes is also increasing. There has been some good news in health in the last decade. The overall incidence of malaria declined between 2008 and 2013, with the prevalence of the parasite in the population falling from 18.2 percent to 6.7 percent, thanks in large part to country-wide, free, long-lasting

insecticidal net distribution campaigns funded by the Global Fund.²² There has been a slow decline in under-five child mortality and infant mortality.²³

However, despite increased levels of health spending by the PNG government over the last decade, improved health outcomes have been incremental at best and non-existent at worst. The United Nations Development Program 2014 report on PNG notes that maternal health is poor and possibly worsening. The report points to Department of Health data from 2013, which showed that the level of antenatal care had declined in the previous three years in all regions except the Highlands, and that there was an extreme shortage of skills in the maternal health field.²⁴ Treating the impact of violence against women and children, which is a particularly horrendous problem in PNG, is a major challenge for the health sector, as it is for the law and justice sector.

PNG has very low numbers of medical professionals per capita. According to the WHO, there are 5.3 nurses and midwives and less than one doctor per 10,000 people.²⁵ While some 85 percent of the population live in rural areas, 80 percent of PNG's medical officers work in urban areas.²⁶

While the government did good work to lift health expenditure during the resources boom, government funding for the health sector has been cut by 40 percent in real terms between 2015 and 2017.²⁷ Although PNG's development partners have agreed to fill gaps in health funding, this has not prevented the closure of rural hospitals and clinics or delivered vital medicines to the rural population.

Government is not the only player in the health sector even if it is the most important one. Bilateral and multilateral donors provide vital assistance. Christian churches have long played an important role in delivering health services in PNG. They have carved out a niche in caring for the poorest, the most remote, and the most marginalized people and have become an integral part of the nation's health system. Some resources companies, as part of their contracts with government, take responsibility for delivering health services in districts where they operate. Some health initiatives driven by the private sector (including the PNG Business Coalition

22. *2014 National Human Development Report: Papua New Guinea*, United Nations Development Program, <http://hdr.undp.org>, p.43.

23. *Ibid*, p.43.

24. *Ibid*, p.43.

25. "Health Service Delivery Profile: Papua New Guinea, 2012", World Health Organization and the National Department of Health, Papua New Guinea, www.wpro.who.int, p.6.

26. "PNG Needs More Doctors", Divine Word University, 20 May 2016, www.dwu.ac.pg.

27. P. Flanagan, "PNG's 2017 Budget: Fiscally Fraudulent", *PNG Economics*, November 2016, <http://pngconomics.org>.

against HIV/AIDS) have delivered impressive results in treating and preventing malaria and HIV.

On recent trends, improvements in the delivery of health services are possible but are dependent on the investment in doctors and infrastructure required and on the health challenges that the population faces. With the national budget in disrepair, it seems unlikely there will be any significant improvement in health in PNG in the near future.

Education – mediocre at best

The average number of years of schooling achieved by adults in PNG is 3.7 for women and 5.3 for men.²⁸ This is the lowest level in the Pacific Islands region and is comparable to the levels of schooling attained by adults in sub-Saharan Africa. In PNG's neighbor Fiji, for example, the average is nearly 10 years. The current completion rate of primary school in PNG is 59 percent.²⁹

Peter O'Neill's government sought to address low levels of education by introducing a tuition fee-free education policy in 2012. The policy has five objectives: to improve access to schools (especially for girls); improve retention; improve the quality of education; strengthen education management; and improve equity to schooling across the country.³⁰

The policy is increasing the numbers of children attending school as well as equity in schooling, but it is not clear that children are receiving a better education. Quantity outcomes have been prioritized over quality outcomes. There are not enough qualified teachers to meet the increased demand for primary school education. There is significant strain on existing schools and teachers accommodating very large classes. More children may attend primary school but not necessarily emerge with the literacy and numeracy skills to either continue their education or make another meaningful contribution to society.

PNG's schooling system has suffered over the last couple of decades from a number of policy shifts, radical changes in curriculum and consistent under-resourcing. A standards-based curriculum replaced the outcomes-based curriculum in primary schools in 2015. There are also problems at the tertiary level. Of the 23,000 students who completed secondary school in 2016, 4,700 sought to continue with higher education but PNG's universities

28. *Human Development Report 2016: Human development for everyone*, United Nations Development Program, <http://hdr.undp.org>.

29. *2014 National Human Development Report: Papua New Guinea*, United Nations Development Program, <http://hdr.undp.org>, p.50.

29. *Ibid*, p.43.

30. G. Walton, A. Swan, and S. Howes, "Papua New Guinea's Tuition Fee-Free Policy: Is It Working?", *DevPolicy Blog*, 10 December 2014, <http://devpolicy.org>.

(which are also suffering from a decline in quality) and vocational training institutions could not accommodate them.³¹

While the O'Neill government has committed to continuing the tuition fee-free education policy, government expenditure on education, like that on health, has taken a large cut in recent years (45% in real terms between 2015 and 2017).³² Further cuts are forecast so it is difficult to be confident about much-needed national improvements to the quality of education in PNG.

Poor governance

Poor governance, weak institutions, lack of capacity in public services, corruption and ineffective leadership have been a source of concern for the PNG public, its foreign partners (in particular its major development partner, Australia) and investors for decades. A key feature of weak governance in PNG is corruption. Corruption is widely regarded to be endemic in PNG. Transparency International's 2016 Index ranks PNG 136th in a list of 176.³³ A number of cabinet ministers have been found guilty of corruption and have or are serving jail terms.

Prime Minister O'Neill came to power promising to tackle corruption and set up the anti-corruption authority, Taskforce Sweep, led by Sam Koim, to lead investigations into high level corruption. When Koim's investigations into O'Neill's alleged connections to fraudulent payments from the PNG Finance Department to Paraka Lawyers came too close, O'Neill disbanded the taskforce. The Prime Minister later avoided being served an arrest warrant through legal injunctions and complex maneuvering in the police force and legal sector, showing personal disdain for upholding the rule of law.³⁴

There are no quick fixes or even straightforward long-term fixes to improving governance and building capacity in public services in PNG. The government itself lacks commitment to improving the performance of national government agencies. The District Services Improvement Program has devolved funds to members of parliament to manage the delivery of a range of services in their districts because the state is unable to guarantee such services. This approach may work in some instances but has many risks. There is an equal chance of implementation failure at the local level, more pressure is put on poorly resourced local level governments and there

31. M. Nalu, "PNG Universities Are Full to Capacity: Secretary", *Pacific Islands Report*, 5 February 2016, www.pireport.org.

32. P. Flanagan, "PNG's 2017 Budget: Fiscally Fraudulent", *op. cit.*

33. *Corruption Perceptions Index 2016*, Transparency International, www.transparency.org.

34. J. Hayward-Jones, "PNG: O'Neill Government Safe for Now But Still Mired in Corruption Allegations", *Lowy Interpreter*, 3 October 2015, www.lowyinstitute.org.

is potential for fraud and corruption. While funds are devolved to districts, they are not invested in national agencies, thus further threatening their capacity to deliver. Still, the O'Neill government is firmly committed to the District Services Improvement Program and the Provincial Services Improvement Program, so it is in the national interest to make them work.

Threats to security come from within, but China's rise presents a challenge

The South-West Pacific region has been relatively benign since the end of World War II. Although the geopolitical landscape in the region is undergoing significant shifts, those changes do not represent serious external threats to PNG's stability.

Domestic security threats

Threats to PNG's stability come predominantly from within. The prevalence of crime and violence, corruption, illegal firearms trade, resource poaching and transnational crime are all disturbing trends. Weak and ineffective policing have exacerbated rather than addressed the growth of crime. Tribal violence and violence caused by disputes over land ownership or mining royalties abounds, particularly in the Highlands region, but goes unchecked. Violence against women and children is at endemic levels and inhibits development as women lack the security they need to take goods to market or ensure their children attend school. Businesses concerned about insecurity have enabled the rapid growth of the private security sector, which now outnumbers police 3 to 1. PNG has a very low police-to-population ratio of 78 : 100,000, compared with 268 : 100,000 in Australia.³⁵ While there is a political commitment to increasing police numbers, the current dire budgetary situation is not likely to permit the planned increases.

Nation-building in PNG is still a work in progress and will likely come under more stress within the next five years. The peace settlement from the war in Bougainville mandated that a referendum on Bougainville's political future be held by 2020. The United Nations and donors, including Australia and New Zealand, have been providing special assistance to the people of Bougainville in the lead up to the referendum. But there is frustration among Bougainville's leaders that the national government is delaying vital

35. D. Connery and K. Claxton, "Shared Interests, Enduring Cooperation: The Future of Australia-PNG Police Engagement", Australian Strategic Policy Institute, 8 October 2014.

preparatory work for the referendum.³⁶ Anecdotal evidence suggests there is likely to be sufficient support for a vote in favor of independence in a vote scheduled to be held in June 2019. If this transpires, however, the PNG parliament can veto the creation of an independent state in Bougainville. Whatever the outcome in Bougainville, it is likely that demands from other provinces, including New Ireland, West New Britain and East New Britain, for greater autonomy or even secession will continue to simmer. The PNG government is ill-equipped to manage challenges to its territorial integrity and will continue to struggle with its nation-building task.

Growing Chinese influence

Like many other developing countries, PNG is also grappling with how it should best deal with the rising influence of China in the region. The growth of China's interests and influence in the Pacific Islands is the biggest story of the decade in the region. In the last few years, China has become the region's second largest trading partner and a significant investor.³⁷ Although China delivers aid very differently from the region's traditional donors and mostly through loans rather than grants, Lowy Institute research shows that China could be the region's third most significant aid partner.³⁸ It is a remarkable advance from the situation a decade ago, when China's interests in Pacific Island states were largely motivated by its competition with Taiwan for diplomatic recognition and its aid contributions characterized as "checkbook diplomacy".

China's presence in the region has undergone a significant shift over the last decade. Beijing now competes with more established players Australia, New Zealand and France for influence with Pacific Island governments. Australia, which has long been the region's and particularly PNG's major trading partner, investor and development partner, can no longer make assumptions about its dominance or Pacific Islands governments' reliance on Australian support. But while China's interests in Pacific Island states appear to be very substantial, it is worth recognizing that these interests are only a small element of the global story of China's rise. China is the world's leading exporter, is seeking to be a more relevant aid partner in the developing world and is growing its portfolio of foreign investments. No Pacific Island country ranks in China's top 50 trading partners. PNG is

36. C. Poriambep, "Referendum Commission Yet to Be Set Up", *PNG Loop*, 18 November 2017, www.looppng.com.

37. P. Gruenwald and D. Wilson, *Pacific Trade – Who Should Be Targeted in Emerging Asia?*, ANZ Research Article, 16 August 2012.

38. D. Cave, "Witnessing an Opaque Power Shift", *Lowy Interpreter*, 5 September 2016, www.lowyinstitute.org.

ranked 124 on the list of countries China exports to and 66 on the list of countries from which China imports goods.³⁹

PNG's size and its resources sector make it China's most significant partner in the Pacific Islands region. China-PNG trade totaled some US\$2.3 billion in 2016.⁴⁰ This represents about a 12-fold increase since 2000. While PNG's trade with Australia is worth considerably more than its trade with China in 2016, China's trade prospects are on a growth trend and Australia's are declining. China's direct investments in PNG totaled US\$496 million in 2015.⁴¹

The PNG government announced in November 2017 that it had signed three memoranda of understanding for new infrastructure projects in the Highlands region with the Chinese government and the China Railway Company, as part of China's One Belt One Road initiative. According to Prime Minister O'Neill, "these projects will enhance agriculture, roads and water supply in parts of the Highlands will improve lives and help people to be more active in the economy".⁴² Chinese investment and the Chinese nationals who work in PNG on Chinese projects tend to attract much attention, but the value of these projects is not likely to overtake the value of individual investments of major resources companies or foreign direct investment from Australia in the near future.

Growing trade ties between PNG and East Asian states beyond China often go largely unnoticed in debate about PNG's international profile. According to IMF data from 2016, Asian states comprise seven of PNG's top ten trading partners, with Singapore second, China third, Japan fourth, Taiwan sixth, Malaysia seventh, India eighth and Thailand tenth.⁴³ When the US\$19 billion PNG LNG project came on line in May 2014, PNG's exporting landscape dramatically changed, with Japan, Taiwan and China competing with Australia as primary exporting markets for PNG.

With Asian countries such as China, Singapore and the Philippines offering more opportunities for education, training, trade and technical cooperation, PNG's attention is increasingly directed to Asia. Asian businesses, large and small, have been setting up in PNG in recent years and

39. *Trade Statistical Handbook 2016 between China and Forum Island Countries*, Pacific Islands Trade and Invest, <https://pacifictradeinvest.com>.

40. *Ibid.*

41. "The Chinese Embassy and PNG Government Jointly Hold a Ceremony for Celebration of 40 Years of Diplomatic Ties and the 67th China National Day as well as the Launching of China-Aided International Convention Centre", The Chinese Embassy in Papua New Guinea, 29 September 2016, www.fmprc.gov.cn.

42. "New Projects to Change Lives in PNG", PNG Facts, 1st December 2017, <http://news.pngfacts.com>.

43. "Trade in Goods with Papua New Guinea, 2016", European Commission, European Union, 17 November 2017, <http://trade.ec.europa.eu>.

helping to strengthen ties. Increasing numbers of workers from Asian countries have been coming to PNG for employment over the last five years, with the Philippines, India, China and Malaysia the main source countries.⁴⁴ PNG students have been increasingly seeking out education in the Philippines as it is cheaper than Australia and has the advantage of English language instruction and direct flights. In turn, the Philippines have become the second largest source of foreign workers for PNG.

While PNG's trade relationships with East Asian countries are growing, the interests of these countries in PNG are as yet largely limited to trade, investment and employment. There are opportunities to strengthen technical cooperation and education links that could be of significant benefit to PNG, but these sorts of ties are only in the very early stages of development.

According to Lowy Institute research, China's cumulative aid to PNG since 2006 totals approximately US\$632 million.⁴⁵ This pales into insignificance if compared with cumulative Australian aid to PNG over the same period (in excess of US\$3.4 billion). However, the majority of China's aid is delivered through loans, so cannot be directly compared to aid delivered by other partners. Chinese aid includes projects in vocational training, communications, fisheries, agricultural technical cooperation, and infrastructure such as a military hospital upgrade, university dormitories and roads. China has a patchy record of aid project implementation and maintenance in PNG, with some projects such as university dormitories praised for their high quality and other promised infrastructure not even delivered.

Beyond its trade, investment and aid links, China has a diaspora, both old and new in PNG, which has helped to expand its influence. It has also invested in soft power, including in television broadcasting and in scholarships, which signals its interest in building a long-term relationship with the people of PNG.

Chinese aid, trade and investment has traditionally been perceived in PNG to come with "no strings attached", but that assumption has been challenged in the last two years. While China has made more loans available to Pacific Island countries, PNG has not rushed to take these up, cautious about the debt obligations that will follow. Prime Minister Peter O'Neill visited Beijing in July 2016, during a period where Chinese diplomats had been putting pressure on Pacific Island states to support its position in the

44. "Who's Coming to PNG and from Where?", Business Advantage PNG, 8 April 2015, www.businessadvantagepng.com.

45. "Chinese Aid in the Pacific", interactive, Lowy Institute for International Policy, www.lowyinstitute.org.

South China Sea. For the first time, O'Neill agreed to "respect China's position" and agreed to the issue of a joint press release that asserted China's "legitimate and lawful rights and interest in the South China Sea, and its right to independently choose the means of dispute settlement in accordance with law".⁴⁶ Although O'Neill clarified that PNG thought maritime disputes should be resolved under international law, his apparent bowing to China's pressure on this key strategic dilemma for the Asia-Pacific was a departure from PNG's longstanding tradition of avoiding involvement in great power debates or aligning with Australia and other Western powers.

China's willingness to put public rather than private pressure on PNG to align itself with its position on such a critical strategic issue suggests that it is no longer content with being perceived to be a generous and undemanding partner. It will be making more public calls on PNG for support for United Nations votes or in other regional disputes. A more demanding China could create difficulties for PNG's ambitions to strengthen its relations with other East Asian states.

Australia, the strategic partner

While PNG increasingly looks to Asia for trade and investment opportunities, its relationship with Australia is likely to continue to dominate its foreign engagement agenda. Australia's A\$550 million per year aid program, its A\$18 billion stock of foreign investment and its significance as a trading partner will ensure that. But Australia itself is cognizant of the challenge posed to its relationship with PNG by the growing influence of China and is taking steps to protect its ties with the government in Port Moresby. The Australian government's commitment to construct an undersea internet cable for PNG rather than see the PNG government engage Chinese company Huawei is evidence of this.⁴⁷

In the 2017 Australian Foreign Policy White Paper, the Australian government said "supporting a stable and prosperous PNG" was one of its "most important foreign policy objectives" and confirmed that it was in the "shared interest" of both nations that "Australia remains PNG's principal security partner".⁴⁸ The Foreign Policy White Paper commits Australia to continuing deep engagement with PNG. In the 2016 Australian Defence White Paper, the Australian government placed a high priority on Australia's

46. "PNG Respects China Position on South China Sea", Radio New Zealand, 10 July 2016, www.radionz.co.nz.

47. "Undersea Cable Deal with PNG Inked Amid Concerns over Chinese Influence in the Pacific", *ABC News*, 14 November 2017, www.abc.net.au.

48. "2017 Foreign Policy White Paper", Australian Department of Foreign Affairs and Trade, www.fpwhitepaper.gov.au.

defense relationship with PNG. The Defence White Paper identifies Australia's second strategic interest as a secure nearer region including PNG and says Australia will continue to be PNG's principal security partner. The Defence White Paper also asserts that "geographic proximity means the security, stability and cohesion of PNG contributes to a secure, resilient Australia with secure northern approaches".⁴⁹

Australia, however, cannot rely indefinitely on geography and existing dominance in aid, trade and investment to maintain a smooth relationship. Australia's decision to imprison would-be asylum seekers in a detention camp in Manus, PNG in 2013 has had serious long-term consequences for the bilateral relationship, which may not be repaired quickly.⁵⁰ The PNG Supreme Court ruled in April 2016 that the detention of asylum seekers on Manus breached the rights to liberty enshrined in the PNG constitution and ordered that detention be ceased. After a further 18 months, Australia has closed the detention center and moved the refugees and failed asylum seekers to other centers in Manus, but has muddied its relationship with PNG and tarnished its reputation. The stand-off between detainees and PNG authorities (and the Australian government) in October and November 2017 over the arrangements for transfer to a new center grabbed international headlines and raised more questions about the nature of Australia's relations with PNG.

The Australian government has been meeting the costs of maintaining the detention center but has been at odds with the PNG government on which of the two bears responsibilities for the refugees and unsuccessful asylum seekers. With Canberra so dependent on the goodwill of the O'Neill government to keep the refugees and asylum seekers on PNG territory, it has become very difficult for the Australian government to deal openly with challenging issues such as the PNG budgetary crisis and allegations of corruption within the PNG political elite. At a time when PNG is facing one of its most serious economic crises and as it prepares to host APEC in 2018, its relationship with Australia is unnecessarily and unhelpfully focused on refugees from third countries.

49. "2016 Defence White Paper", Australian Department of Defence, www.defence.gov.au.

50. J. Hayward-Jones, "The Manus Island Stand-Off and Australia-PNG relations", Australian Institute of International Affairs, 2 November 2017, www.internationalaffairs.org.au.

APEC

PNG is due to host the APEC Leaders' Meeting this year. Prime Minister Peter O'Neill volunteered the PNG capital Port Moresby as the host city in better economic times and has reportedly budgeted PGK800 million (US\$246 million) since 2014 for the event, with PGK300 million allocated expenditure in the 2018 National Budget.⁵¹ Hosting APEC is the first priority framing the 2018 National Budget. The Australian government is assisting by contributing approximately one-third of the costs of hosting the Leaders' Meeting, principally by supporting security and logistics. Prime Minister O'Neill also enlisted the support of the private sector to host the summit, with LNG producer Oil Search funding the purpose-built APEC Haus convention center through a tax-credit scheme.⁵² The APEC summit offers a unique opportunity for the government to enhance its growing links with East Asian partners and build international interest in investing in PNG, but it will need to work hard to convince the public of these merits given that budgets for essential government services are under huge pressure and already being diverted to pay for an event that provides little immediate direct benefit for the population.⁵³

51. "2018 National Budget: Vol.1 Economic and Development Policies", *op. cit.*

52. G. Jennett, "Australia Bankrolls Papua New Guinea APEC Summit Costs, Stymies China", *ABC News*, 31 January 2017, www.abc.net.au.

53. J. Pryke, "Lingering Questions for PNG's 2016 Budget", *Lowy Interpreter*, 12 January 2016, www.lowyinstitute.org.

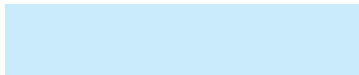
Looking forward

The newly re-elected government of Peter O'Neill has a difficult road ahead in governing PNG through uncertain economic times. The economy is over-reliant on the extractives industry and while PNG has been able to ride the boom-bust cycle previously, it would be naive to assume that world prices for PNG's key resources exports will again rise to the levels required to deliver the revenue for sustainable economic growth. Finding more reliable and diverse means to invest in critical service delivery in education and health, better law and order, national infrastructure and job creation is critical if PNG is to avoid a serious deterioration in living standards.

While PNG can avoid the collapse of the state, on current trends the effectiveness of the state seems likely to decline over time as politicians, businesspeople, and individuals look for alternative means to sustain their communities. The PNG population has a long record of resilience and self-sufficiency, with the population in the rural areas of the country already relying on subsistence agriculture and their own means of managing law and order and recovering from natural disasters. If the state is unable to deliver, community and business leaders will resort to contracting out local-level service delivery, security and other functions of the state. Development partners can assist in the short-term by filling gaps in national government funding of education, health and infrastructure. PNG can ill afford to lose a generation of children's education to its current budget woes.

But even if there is serious decline in PNG in the near to medium term, there are reasons to be optimistic about the long-term future. PNG has an abundance of natural resources. Resources companies are likely to continue to invest in PNG despite security problems and government mismanagement. Revenue should be forthcoming for at least some key resources over the coming decade. The development of more agribusiness and a more vibrant local enterprise sector can provide employment for greater numbers of young people. The emergence of new technologies may enable change the current generation of leaders cannot even imagine.

The next generation of leaders face a daunting challenge in seeking to turn around PNG's negative development trajectory. They will need the support of all PNG's development and trading partners if they are to create a more positive future for their country.



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