

THE POLITICS OF ECONOMIC REFORM: THE FAILURE OF PNG'S 1995 STRUCTURAL ADJUSTMENT PROGRAMME

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This article provides a general overview of the events surrounding a recent attempt to reform and restructure Papua New Guinea's political economy. Faced with a severe economic crisis in 1994, the Papua New Guinea government approached the World Bank for financial support. In order to receive this financial assistance the Papua New Guinea government was obliged to implement a programme of structural adjustment. Despite some early successes, the Structural Adjustment Programme largely failed. Starting with an analysis of the events which led up to its introduction, this article explores the major events of the 1995-1999 period before offering a brief analysis of the causes of the programme's failure.

Cet article retrace et analyse les principales étapes de la restructuration du système économique de la Papouasie Nouvelle Guinée. Ce pays confronté en 1994 à une grave crise économique, a pris l'initiative de demander l'aide de la Banque Mondiale pour mettre en œuvre un programme de réformes. L'octroi de cette aide devait être conditionné par la mise en place d'un ensemble de réformes structurelles (Structural Adjustment Programme) lesquelles en dépit de rares succès devaient durant la période 1995-1999 se révéler un échec.

I INTRODUCTION

Situated in the Southwest Pacific, Papua New Guinea (PNG) is endowed with a rich natural resource base, which includes major gold and copper deposits, large oil and natural gas reserves, and extensive forests and maritime fisheries. Yet despite this abundant source of wealth PNG still struggles to achieve sustainable economic growth. Moreover, throughout its independent history PNG has been periodically beset by periods of severe economic crisis. One such crisis occurred in 1994. Faced with declining terms of trade and increasing fiscal difficulties, the PNG government was forced to approach the donor community for assistance. While the Australian government provided some immediate monetary aid, most financial assistance came in the form of a World Bank Structural Adjustment Programme (SAP) loan. Conditionality agreements meant, however, that such aid was dependent upon acceptance of a series of stringent structural adjustment measures.

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With economic crisis looming and few options remaining, in 1995 the government of PNG was obliged to agree to the implementation of the World Bank's Programme of reform.

Beginning with an analysis of the events which led up to the introduction of the SAP, this article goes on to explore the major events of the 1995-1999 period before offering a brief analysis as to the causes of the SAP's failure. Begun in 1995 the SAP was beset by problems from the very start. The data available suggests that the major reason for the failure of reforms can be traced largely to the self-interested predatory behaviour of the country's politicians. While a number of other factors contributed to this failure – including a devastating drought in 1997 and protests over the attempt by the PNG government to use mercenaries to end the long running secession conflict in Bougainville – the main fault is seen to lie with the country's politicians, with the Skate administration (1997-1999) playing a particularly large role in this process. The aim of this article then is to provide an overview of the events surrounding the attempts to reform and restructure PNG's political economy.¹

II BACKGROUND TO THE CRISIS

The shock closure of the Panguna mine on Bougainville in 1989 caused a complete reevaluation of the expected revenue base for the 1990 national budget and major budgetary reductions for the upcoming financial year.² The loss of the revenue associated with the mine meant that an expected budget surplus was quickly transformed into a deficit. Although favourable conditions on the international mineral markets in the early 1990s quickly restored the government's revenue base and produced sufficient income to offset the loss of the mine, the fall in the ratio of gold-derived revenue resulting from the closure of the Panguna mine meant that government revenues became increasingly reliant on oil royalties. The rapid growth of the PNG economy in the early 1990s was thus powered almost exclusively by a very narrow resource sector. In an attempt to move away from this narrow sectoral domination the 1993 budget focused on an expansionary fiscal policy and reliance on supply side measures (especially tax reform) in order to stimulate both non-mining and non-petroleum private sector investment and trade liberalisation. New policies introduced during this period to help with this diversification included labour market reforms, increased support for the agricultural sector and increased social service expenditure in order to improve the country's stock of human capital. The reforms introduced by this Budget were thus to have laid the groundwork for an increasingly export orientated approach in domestic industrial policy with a heavy emphasis on sectoral diversification (Fairbairn, 1993: 21; 1993a: 16). Things seemed to be turning around when in 1993 real GDP grew by a staggering 16 per cent. The resulting boom led to school fees being abolished, the introduction of commodity

1 I would like to thank Bethan Greener-Barcham, John Henderson and Ueantabo Neemia-Mackenzie for feedback on successive drafts, as well as those in Papua New Guinea who took time out of their busy schedules to talk to me about the 1995 SAP. Thanks also to the Asia 2000 Foundation for providing me with an APEC (Asia Pacific Economic Cooperation) Research Scholarship, which allowed me to travel Papua New Guinea to undertake the necessary fieldwork for this paper.

2 The situation on Bougainville, while leading to the loss of one of the country's main sources of revenue, also made additional inroads into the country's annual expenditure, with defence spending rising from K40 million in 1988 to K92 million in 1991.

price support and increases in public service salaries. Personal and corporate taxes were also heavily reduced over this period and wages were deregulated in an attempt ostensibly to stimulate employment. This boom, however, barely made an impact on unemployment levels, so that despite an initial Programme of budget reduction as well as favourable international markets, the early 1990s were characterised by growing budget deficits. This serious fiscal imbalance, coupled with a dramatic slump in international mineral and petroleum markets in late 1993 and early 1994, meant that by March 1994 the PNG government was in the midst of a growing fiscal crisis.

III THE CRISIS

As pointed out above, the fiscal crisis facing the PNG government in 1994 emerged from a number of factors. In early 1994 international oil prices had fallen significantly below the projected figures used by government planners to prepare the budget income estimates for the 1993/94 financial year. Rather than seeking to finance their growing debt with an international loan, the PNG government at first attempted to finance its growing deficit through the domestic banking sector. However, without foreign currency backing to finance the country's growing deficit the country's banking system had to draw down from the country's foreign reserves, thereby weakening its overall fiscal position. Recognising that urgent change was needed, the government undertook dramatic budget revisions in March 1994, releasing a revised mini-budget in an attempt to alleviate the country's fiscal burden. Expenditure reduction measures coupled with increased export taxes on forestry products and revised personal income tax regulations were also undertaken in an attempt to limit the growing budget deficit. Yet these measures proved insufficient. The country's underlying fiscal imbalances continued to grow throughout the first three quarters of 1994, with the country's fiscal deficit rising to over 10 per cent of GDP and foreign exchange reserves falling from 1.8 months of non-mining imports at the end of 1993 to only half a month by the end of September 1994.

A month earlier, a change of government in late August had led to the former Finance Minister, Sir Julius Chan, taking over the leadership of the country. As the country's fiscal crisis deepened, the new Chan government devalued the currency (the Kina) by 12 per cent in an attempt to combat the growing liquidity problems brought about by this macro-economic crisis. Despite the devaluation, large outflows of foreign capital continued unabated and in October the Chan government was forced to abandon the long-standing 'hard Kina' policy and float the Kina (*Post-Courier*, 5 October 1994: 1). While the adoption of the floating rate strengthened the effectiveness of the country's monetary policy, major capital flight out of the country continued and the contractionary fiscal policy of the 1994 mini-budget began to disrupt the country with hospitals and schools having to be closed due to lack of funds. The severity of the country's fiscal position led to the Australian government providing the PNG government with A\$111 million in loans in order to help stabilise the country's steadily worsening macro-economic environment.³ Unfortunately, the continued deterioration of the country's fiscal position meant that even this A\$111 million loan could not prevent a

3 Despite this, by June 1995 all government funds for health, education and infrastructure projects had been spent.

budget shortfall. As a result, the PNG government was forced to approach the Australian government, the IMF and the World Bank for additional funds to cover its budget deficit.

The initiation of dialogue between the government of PNG and the twin Bretton Wood institutions – the World Bank and the IMF – was met, however, with widespread public resistance. This resistance emerged from a number of sources within PNG society, with NGOs being particularly vocal against the imposition of any structural adjustment Programme. The General Secretary of the Public Employees Association (PEA), Jack Kutal, went so far as to publicly announce that the interests of the Bretton Woods institutions and PNG were not the same (*Post-Courier*, 24 October 1994: 5).⁴ A strike by 18,000 teachers in March 1995, the first ever by public employees, demonstrated the depth of public feeling against the economic hardship brought on by the government's mismanagement of the fiscal crisis, as well as the broad current of discontent underlying the attempts by the PNG government to obtain funding from the World Bank and the IMF (Hayashida, 1996: 155). Nonetheless, in April 1995, agreement was reached between the PNG government and the Bretton Woods institutions over the establishment of a standby facility and the release of an SAP loan.⁵ This agreement was followed by the immediate release of the first US\$25 million tranche of the SAP loan. It should be noted that the agreement between the government and the Bretton Woods institutions did receive support from some of the country's most senior politicians.⁶

IV THE REFORM PROGRAMME

Problems occurred in the implementation of the SAP right from the very beginning.

The five major components of the PNG government's Structural Adjustment Programme (SAP) were:

- restore and maintain a stable economic environment by sharply lowering fiscal deficits and improving fiscal management
- implement a series of structural reforms to enhance PNG's competitiveness (by liberalising trade and investment regimes and privatising key government assets) and restore business confidence – thus bringing about a recovery in private investment
- promote sustainable, environmentally-sound natural resource development through implementation of effective forestry conservation and revenue policies
- substantially improve public service delivery through restructuring of public expenditures, an increase in public investment and the development of new non-governmental mechanisms to increase transfers to poorer provinces

4 Interviews with Mr Brian Brunton, Greenpeace and Dr Orovou Sepoe, Lecturer in the Department of Political Science and Public Administration UPNG, 24 November 1999 (Port Moresby).

5 For a complete list of the 27 conditions of the Structural Adjustment Programme that accompanied the release of the loan, see Mawuli, 1997.

6 See, for example, the speech by former Prime Minister Rabbie Namaliu to the 'Politics, Business and the State in Melanesia' conference held in Sydney on 4 August 1995. A copy of this speech can be found in the *Pacific Economic Bulletin* (1995), Vol 10, No 2.

- support measures to improve project and programme implementation including emergency relief Programmes (Chand and Stewart, 1997: 62; Proctor, 1996: 109-110).

The World Bank's SAP loan was to be provided in two lots of US\$25 million each. Release of the second segment required the completion of a number of the key objectives of the SAP, including satisfactory preparation of the 1996 budget and an assessment of the impact of the new Organic Law on Provincial and Local Level Government (OLPLLG).

In presenting the 1995 budget the government failed to begin its restructuring of the country's agricultural sector as set out in the SAP objectives, promising instead to review current arrangements with a view towards phasing out the expensive and extensive commodity price support scheme. In addition, in October 1995 the head of the National Forest Authority, Jean Kekedo, was sacked over allegations that she had not acted fast enough to approve legitimate logging projects and that she had failed to produce a new forestry plan, thereby delaying the restructuring of the country's forestry management systems as required by the SAP. Despite this failure, some SAP objectives were able to be met at least to some extent in 1995. The problem is that even these successes were conditional at best. The best example of this can be found in the largest and most far-reaching of these reforms, concerning the reform of the country's provincial system of government.

A *The New Organic Law (Political Reform)*

At independence, in addition to the central government, provincial parliamentary governments were established with responsibility for a number of public services, including education, health and local infrastructure.⁷ These provincial governments were supported by financial and staff resources from the centre, but a general lack of capacity combined with high levels of corruption meant that many did not function very efficiently. In June 1995, however, the enactment of the new Organic Law on Provincial and Local Level Government (OLPLLG), in accord with the neo-liberal decentralist goals of the SAP, meant that this entire layer of government was removed. While the 19 provinces remained in place, the 500 salaried provincial level politicians who had represented these provinces lost their positions as powers were devolved both downwards to local governments and upwards to the national assembly. This change meant that National Parliament MPs became members of provincial assemblies and presidents of their electorates' local-level assemblies. Regional MPs also took on the responsibilities of Governor of their respective provinces, while assembly members of the 267 local-level governments would also sit in the provincial assemblies. The creation of this new bipartisan model, while in accord with the goals of the SAP, gave national MPs considerably more power over the distribution of resources within their electorates.

The intent behind the new Act had been to eradicate provincial mismanagement through the removal of administrative fragmentation. The goal was to remedy the chronic lack of

7 The initial establishment of these provincial governments had more to do with placating the secessionist tendencies of the North Solomons Province than with any desire to promote administrative reform. Despite this, the provincial governments did help spread the country's administrative load through the administration and provision of basic services and resources.

accountability and coordination between provincial and central governments. Decentralisation was supposed to increase government participation at the community level and thus improve local service delivery and distribute funds more evenly. The implementation of the provincial and local-level reforms, however, faced serious infrastructural, financial and human resource constraints of their own (Yala and Levantis 1998: 14). The new political system suffered from a lack of legislative and infrastructural support, with 14 of the 'new' acts referenced as 'to be enacted' in the new Organic Law when it was implemented in 1995 and still waiting to be enacted in 1999 (Sause and Kinkin 1997). Similarly, a legislative vacuum existed at the provincial and local levels as large numbers of existing laws were yet to be amended to be brought in line with the new legislation. Inadequate infrastructure development also meant that many district staff remained confined at provincial headquarters, unable to properly deal with the demands of their provinces' more remote areas.⁸ Despite the removal of a layer of government, the distribution of funds to the provinces and local-level governments remained irregular at best, and the distribution of responsibilities between the various levels of government proved problematic due to a combination of ill-defined objectives and low levels of coordination. The implementation of the new organic law in 1995 thus did little to alleviate the problems of low capacity and chronic lack of infrastructure at the local and district level (Gupta and Ivarature 1996: 51-54).

Nevertheless, despite these multiple problems, the transfer of former provincial level functions to lower levels of government occurred at a startling rate.⁹ This transfer of functions without the establishment of suitable levels of infrastructural support and accountability meant that the opportunities for the emergence of problems of mismanagement and corruption were enormous.¹⁰ The linking of local and national level politics through the new membership requirements of the provincial assemblies may thus have done little for local-level development, and instead merely created a new opportunity for corruption and patronage-based politics (May 1997: 394-395).¹¹ To many, the new Organic Law was seen as merely a vehicle created to ensure that funds remained with politicians at the national level.

8 Interview with Mr Daniel Aloï, Lecturer and Head of Department, Department of Political Science and Public Administration, UPNG, 24 November 1999 (Port Moresby).

9 Interview with Mr Daniel Aloï, Lecturer and Head of Department, Department of Political Science and Public Administration, UPNG, 24 November 1999 (Port Moresby).

10 These very real problems of inadequate legislative, infrastructural and administrative capacity at the local government level were further compounded by the fact that funding levels in the form of provincial grants had actually dropped in recent years, falling 22 per cent in the 1998-1999 financial year alone. This situation was made even worse by the fact that many provinces were not receiving their funds until late into their budgetary year, with the Eastern Highlands Province (for example) not receiving its 1997 allocation until October of that year.

11 While the old pre-1995 provinces were bureaucratic, corrupt and provided little room for public participation they did, however, provide alternative sites of power and to some extent acted as a check on the excesses of the central government (Ghai and Regan, 1992). Indeed, some commentators have argued that successive national governments gave provincial governments little chance to improve, and that the politics of patronage and corruption that existed at the national level led to the disregard by national level politicians of the spirit of co-operation and consultation that underlay the original Organic Law (Ghai, 1997, p. 321).

The singularly large vote in the national Parliament supporting the amendment underscored this belief (Hayashida, 1996: 153).¹² Thus, while the provincial reforms were decentralist in intent, their end result appears to be the increased centralisation of power in the capital.

B Other Problems with the SAP

Graft and corruption are massive impediments to development in PNG, and the reforms of the country's system of provincial government, and the opportunities for corruption that it enabled, were merely the latest in a long line of problems associated with these issues. In more recent years this link between politics and material gain, otherwise known as corruption, has been institutionalised through the establishment of the Electoral Development Fund (EDF) and the Electoral Development Programme (EDP). One of the key objectives of the 1995 SAP was the removal of the EDP and the EDF.¹³ However, the PNG government refused to abolish these so-called 'Slush Funds' and related Programmes of price support as advised by the IMF and the World Bank. The government argued that the EDP and price support schemes were necessary to the country's social well-being as they allowed money to be introduced into rural areas (*Post-Courier*, 9 January 1995: 3). This decision, however, had more to do with the country's system of patronage-based politics than with concerns about the efficient functioning of the economy. PNG politicians were unwilling to modify systems (such as the price support scheme) that provided many rural producers, who also happened to be voters, with their only definite source of income.¹⁴ For the same reasons, the SAP goal of phasing out the EDF, which provided each MP with K300 000 for 'developmental' projects within their own electorates, also faced strong political opposition.

One of the key constraints in the battle against corruption in PNG is the sorry state of the country's public finance accounting systems. Over the years, the misuse of the country's accounting system, which was a mixture of cash and accrual accounting systems, contributed

12 This is a belief also voiced by Manus' Governor, Stephen Pokawin, in his claim that the new Organic Law was nothing but an administrative extension of the national government as powers once vested with the provinces disappeared and were now vested in the national government (*Post-Courier*, 13 February 1998: 1). The establishment of the National Monitoring Authority (NMA) under section 110 of the Organic Law on Provincial Government and Local-Level Government does signal a commitment by the government to increased accountability and to transparency in the governance process at the local and provincial levels. Drawing its members from government agencies and wider civil society, the NMA's major role is to monitor the implementation of government policies, especially as to how they pertain to sub-national levels of government in the new provincial government system. The NMA's mandate does not, however, extend to the monitoring of the use of state funds by elected officials, an oversight that hampers its ability to render government spending fully accountable. Another key problem that the NMA faced was the lack of clear guidelines on how it was to be funded and resourced, a problem that could restrict its ability to demand improvements in performance by government agencies (AusAID, 1997).

13 The EDF and EDP were allocated to each member of the national Parliament and were operated by them for the direct provision of infrastructure and services in their electorate.

14 Elections in PNG are dependent upon local and not national level issues. Parliamentary seats are won by mobilising parochial interests and kinship ties rather than policy concerns or party loyalties. Politicians are thus more dependent upon the support of 'big men' and their 'wantoks' than they are on parties.

greatly to the country's problems of fiscal mismanagement.¹⁵ The apparently arbitrary assigning of payments received to earlier periods by some departments (when they should be accounted for as part of the current period) contributed greatly to the destabilisation of the Kina. This arbitrary accounting practice, and others like it, enabled expenditure and revenue records to continue to be classified incorrectly, thereby reducing transparency in the management of public finances. In an attempt to overcome these problems, one of the key objectives of the SAP was the passage of The Public Finances (Management) Act in order to restructure and clarify the country's public finance accounting systems. However, despite its passage into law in 1995 the lack of any subsequent enforcement of its guidelines (such as requiring annual accounts from departmental heads) meant that its value as an agent for increased accountability within the public service was lost.¹⁶

One success for the SAP in 1995 was the abolition of the EDF in the 1996 budget amidst vociferous political opposition. Although this may have seemed to have been a great victory for the SAP, the EDF's replacement by the Rural Action Programme (RAP) meant in reality that little had really changed except for the name of the institutional means by which PNG politicians engage in corrupt activity.¹⁷ The release of the country's 1996 budget in late 1995 also accompanied the release of the second phase of the reforms to be implemented under the SAP. In general the overall aim of the second phase of the reforms was to be the review and rationalisation of the public sector in order to improve its efficiency. The reform Programme was also intended to focus on possibilities for private sector growth and the creation of sound policy frameworks in order to reverse the continuing country-wide decline in basic social services. Unfortunately the second phase of reforms did not have a very auspicious start with the country's civil servants receiving a 10 per cent pay rise in January 1996, 6 per cent higher than that announced in the budget. However, in spite of this lacklustre beginning to the second phase of reforms, and a decidedly mixed year of success in the implementation of the SAP, by the end of 1995 the country's macroeconomic environment was looking somewhat healthier. Despite an overrun in recurrent expenditures, a small budget surplus was achieved in 1995, although at the cost of a substantial cut in essential services and the public investment Programme. While the fiscal accounts registered a marginal surplus in 1995, an improvement over a target deficit of 1 per cent of GDP, the low level of expenditures on priority areas began in 1996 to lead to an even greater deterioration of service delivery levels.¹⁸

15 In a cash accounting system the concept of matching rules directs that cash receipts and payments that occur within a period are reported in that period. In an accrual accounting system by contrast the concept of matching dictates that revenues earned (but not necessarily received) in a period are matched with expenses incurred (yet not necessarily paid) within the period.

16 One of the few positive achievements of the Public Finances (Management) Act, and one of the few successes of the SAP, was the creation of the Public Accounts Committee in order to oversee the management of public funds. Recent years, however, have seen this committee fade away into obscurity.

17 The Rural Action Programme, to all intents and purposes, fulfils the same function as the EDF that it nominally replaced, which is to provide funding for politicians to 'develop' their electorate.

18 Economic activity was, however, estimated to have declined by about 5 per cent in 1995 due to declining activity in the agricultural and industrial sectors and particularly in the mining,

V PROBLEMS WITH THE LOAN

Problems with the loan surfaced in early 1996. Talks between the World Bank and the PNG government over the delivery of the second instalment of the SAP loan broke down due to disagreements over a number of Forestry and Logging Code amendments under the PNG Forestry Act. The World Bank argued that it would not release the second tranche of the SAP loan unless evidence was presented that there had been progress on the reforms outlined under the initial SAP agenda¹⁹ (Hayashida, 1997: 201). Matters appeared to be resolving themselves when the PNG government agreed with World Bank representatives that amendments to the Forestry Act would be limited to technical matters only. Tensions reached a new high, however, when the PNG parliament passed amendments to the Forestry Act altering the roles of the Minister for Forests and the Forestry Authority Board.²⁰ The World Bank was concerned over the way in which the power to appoint members of the Forestry commission was vested with the Forestry Minister rather than the National Forestry Authority itself (*Post-Courier*, 30 July 1996: 1). In response to this move, the World Bank asserted that the entire SAP loan would be cancelled unless the amendments to the Forestry Act were repealed; proposed new import duties and the planned reintroduction of certain price controls would also have to be cancelled. The PNG government countered this response with the claim that the World Bank was directly interfering with its sovereignty as an independent country (*Post-Courier*, 1 August 1996: 1). In the end this deadlock led the World Bank to a 90-day ultimatum on the PNG government to enact legislative amendments in order to meet the nine outstanding conditions of the first phase of the SAP. In an attempt to overcome the impasse desperate meetings between the PNG Finance Minister and World Bank staff were held in Washington throughout September. As a result, a compromise agreement was able to be reached, and on 8 October 1996 the PNG parliament passed the Forestry (Amendment) Bill 1996. This still left four of the nine loan conditions unfulfilled. In the end, however, the President of the World Bank recommended a waiver on the remaining four given that steps had been taken by the government towards resolving them (Kavanmur, 1998: 109). With the major impediment to the delivery of the second tranche of the SAP loan having been removed, the second payment of the loan was released in early 1997. However, some of the conditions associated with the release of the funds were extremely politically sensitive. The one that provoked the most widespread protest was the call for nationwide land reform.

Land and Forestry Reform

Land tenure issues in PNG were seen by the World Bank as a formidable barrier to investment and development. The World Bank argued that existing government land policies

construction and service industries. Similarly, non-mining GDP declined by more than 3 per cent in 1995 because of weather-related shortfalls in log and coffee production and lower-than-expected public investment outlays.

19 The issue was not resolved until December of that year.

20 The amendments to the Act undermined the independence of the National Forestry Authority Board and enhanced the powers of the then Minister for Forests, Andrew Baing.

were complex and often contradictory. The reopening of land compensation questions many years after settlement had given rise to land disputes and undermined investor confidence in the security of land titles and leaseholds.²¹ One of the key objectives of the SAP was the reform of the country's land registration practices, a process to be codified in the passage of a proposed Land Mobilisation Act. However, as had happened many times before, the proposed modification of land tenure issues prompted vocal protests and sometimes violent disputes. In one rally, university students set fire to five government vehicles in protest over the proposed legislation. In a separate incident, the law firm drafting the proposed Land Mobilisation Act had to cut short a fact-finding mission when protests became increasingly violent. Such disturbances led the government eventually to place an indefinite freeze on legislative investigation of land reform issues (Wesley-Smith, 1996: 431).²² The timing of the land reform legislation, however, may have contributed to its failure to gain popular support, as it followed immediately in the wake of the provincial government reforms, legislation widely perceived as having been railroaded through Parliament in the face of public opinion (*Post-Courier*, 16 June 1995: 2).

Another section of the reform Programme that saw little headway in its implementation in 1996 was the reform of the country's public service. One of the few civil service reforms to be enacted in 1996 was the movement towards contractual arrangements for senior public servants. This was designed to improve the country's policy management capacity in an attempt to attract and retain the 'best' possible professional civil servants. The use of this contractual approach, however, led to a weakening of the already tenuous professionalism of the public service. Many of the contracts between the state and senior public servants were negotiated outside of processes of the Public Service Commission or the Department of Personnel Management. While they are all supposed to be performance-based, this does not appear to be the case in practice. Remuneration of the contracts is extraordinarily high, while stringent buyout clauses provide high levels of security to the appointees regardless of their performance standard.²³ The movement towards high-level remuneration contracts for senior civil servants ran completely contrary to the PNG Government's SAP-inspired policy stance of containment of public sector wages. This policy stance had meant that real wages of public servants as a group had fallen sharply over a period of years. However, the introduction of contractual arrangements to attract and retain the 'best and brightest' into the country's senior public service led to massive increases in the salary levels that these

21 Land disputes are endemic throughout PNG due to both the communal nature of land tenure and the lack of established systems of land registration in most areas. The customary nature of the land tenure system means that investment is a very uncertain business with high levels of risk involved (Crocombe and Hide, 1987, pp. 354-359). Such problems with land tenure have long been an impediment to private sector development (Institute of National Affairs, 1981). At least 97 per cent of the total land area of PNG remains in the hands of customary land owners.

22 The PNG government continues to register land under clan ownership in an attempt to avoid future land disputes, and to facilitate land sale if that is what the clan desires.

23 Interview with Mr Daniel Alois, Lecturer and Head of Department, Department of Political Science and Public Administration, UPNG, 24 November 1999 (Port Moresby).

senior civil servants were receiving.²⁴ Knowledge of the favourable salary rates that their departmental heads were receiving thus led to the growth of discontent among lower level civil servants who had seen their pay steadily decreasing in real terms.²⁵ The high levels of remuneration available at the top thus exacerbated already low feelings of morale within the PNG public service as a result of the policy of wage containment.

Even so, there were some positive developments emerging in the implementation of the SAP during 1996. The government introduced a new forestry tax regime designed to increase forestry-derived revenues and enhance the prospects for sustainable forestry activity. While certain aspects of these reforms were later amended at the insistence of the World Bank, the majority of the reforms were retained. Financial support to the forestry sector was maintained through budget allocations to the National Forestry Authority. A new sustainable cutting policy was introduced, accompanied by the creation of a logging code of practice with its associated improved enforcement of technical, environmental and conservation requirements. Additional policies were also implemented to prevent forest clearance on a large-scale; measures were also undertaken to strengthen the integrity and independence of the Forest Board. These successes were, however, far from typical, and unfortunately not to last.

VI A YEAR OF TROUBLES

The problems of 1995 and 1996 were further compounded in 1997. In March of that year Commander-in-Chief Brigadier-General Jerry Singirok challenged the government over its hiring of mercenaries to put an end to the continuing troubles on Bougainville. During the ensuing two-week period the country was shaken by considerable civil unrest, with looting and rioting occurring in many parts of the country. In the wake of mounting pressure over the incident, the Prime Minister, Sir Julius Chan, and two of his leading Ministers stepped aside in late March pending an inquiry into their role in the affair. While the Prime Minister was later cleared of all charges, Sir Julius lost his seat in the July national elections, with Bill Skate being sworn in as the country's new Prime Minister. What became known as the Sandline affair revealed, amongst other things, the continued lack of accountability and high-levels of corruption that permeated the country's political system. One of the worst cases emerging out of the incident was the revelation that the Finance Minister had deliberately disregarded procedures outlined in both the Public Finance Management Act and the Appropriation Act in order to obtain funds to help pay the mercenaries (Kavanmur, 1998: 115). Anecdotal evidence also pointed to the fact that officials, fearful for their jobs, had provided advice on how the Minister could best maneuver around the various legislative

24 Some of the remuneration packages that these departmental and agency heads received were as high as K500,000-K600,000, levels that are comparable, even with unfavourable exchange rates, to their counterparts in OECD countries.

25 Interviews with Mr Daniel Aloj, Lecturer and Head of Department, Department of Political Science and Public Administration, UPNG, 24 November 1999 (Port Moresby) and Mr Clarence Hoot, Ministry of Trade and Industry, 25 November 1999 (Port Moresby).

and procedural barriers blocking his way to accessing further public funds.²⁶ Following in the wake of the Sandline affair, the 1997 general election saw 2,371 candidates stand for the 109 seats in the national Parliament. Only 51 (48 per cent) of standing MPs were re-elected.²⁷ The fact that 36 of the 109 elected were independents demonstrated the deep feeling of disenchantment felt by the electorate about the performance of political parties in general, and the performance of the past government in particular, in dealing with the country's macro-economic and social woes (Manning, 1997: 3).

Early 1997 also witnessed the destruction of much of the country's yearly copra and cocoa crops as parts of the island continent were severely damaged by tropical cyclones. The damage caused by the tropical storms was then compounded by the onslaught of one of the worst droughts in the country's history. Lasting from mid-1997 until early 1998 the drought crippled agricultural production, caused the closure of the Ok Tedi and Porgera mines, and left more than 250,000 people in a state of near-starvation. In 1997 the main impact of the drought had been on small-holder and subsistence production as many commercial tree crops were still able to be harvested. In 1998 this situation was reversed, with levels of coffee, copra and cocoa exports falling dramatically. The biggest source of contraction in GDP in 1997 was, however, due to the mineral sector failing to maintain its previously high levels of production, due mainly to the closure of the Ok Tedi and Porgera mines during the drought. The cyclone and drought caused severe disruption to the country's agricultural production, possibly setting back its development as a growth sector for many years. This may also have contributed to an increase in the importance of revenue derived from mining and petroleum, further deepening the reliance of the PNG economy on these sectors.

The Sandline crisis and the devastating effects of the drought meant little progress was made on the SAP in 1997. However, in line with its aims, and in a desperate attempt to limit the potential for a fiscal blow-out, the incoming Skate government instituted a one-year freeze on employment and wage increases for public servants from 19 November 1997. Nevertheless, the continuing existence of high levels of corruption and the unforeseeable destruction of much of the country's agricultural production made 1997 another step backwards for PNG's political economy.

VII A NEW YEAR AND A NEW BEGINNING?

The severe strain placed on PNG's economic and socio-political infrastructure in 1997 led the World Bank to support a request by the incoming government to delay the presentation of the national Budget until March 1998. The delay was requested to allow the incoming government to formulate priorities on expected reviews of civil service and public

26 Interview with Professor Ted Wolfers, Prime Minister's Department, 21 November 1999 (Port Moresby).

27 Only 40 percent of standing MPs retained their seats in the 1992 election.

spending²⁸ (*Post-Courier*, 4 November 1997: 2). The severe economic strain of 1997 had also led a number of PNG's most prominent citizens to criticise the interventionist policies of the Skate administration. The President of the Business Council of PNG had publicly stated that the private sector was worried about a number of recent government decisions, and that development initiatives based on annual budget assumptions were not really promoting development (*Post-Courier*, 21 January 1998: 4). In an attempt to dispel such criticisms the government hosted a two-day national economic summit in February 1998 aimed at pooling ideas from public and private sector organisations and non-government organisations to form long-term policies to ensure continuing development. In the wake of the summit a Consultative Implementation and Monitoring Council (CIMC) was created in order to make sure that the recommendations of the summit were actually presented to government. The CIMC was to be funded by AusAID through the Institute for National Affairs, and was composed of representatives from the government, the private sector, NGOs, churches and wider civil society.²⁹ Unfortunately, in spite of a continued commitment by such groups to the SAP reform process, the same could not be said of the Skate government.

In the wake of the scandal surrounding the Sandline incident, the Skate government's continued breaches of statutory law requirements with regards to central bank financing and support for burgeoning industries raised serious questions about the commitment of PNG's incoming government to the rule of law. Although the Central Bank Act placed restrictions on Central Bank finance available to the government there were serious breaches of this restriction by the Skate government following its implementation. Such political manipulation in 1998 eventually led to the Central Bank exceeding its statutory limit on government debt and government advances, a development supposedly impossible under the aegis of the Central Bank Act and its various amendments. Thus, despite the intent of the Act, overriding control of monetary policy was still held by Cabinet. In a similar case, while the Industrial Development (Incentives to Pioneer Industries) Act was repealed by the Skate government in 1998, the government nonetheless granted pioneer status to three separate companies within weeks of the passage of the new legislation.³⁰ Claiming that the granting of pioneer status to the companies was legitimate as the new legislation would not come into effect until the beginning of 1999, the government nevertheless failed to observe the 60-day public posting period required under the Act.

Similarly, the sharp decline in 1998 in both international forestry prices and demand for forestry products following the Asian financial crisis led to massive pressures being brought to bear upon the PNG government by private sector interests within the forestry sector to

28 When it finally emerged, the 1998 budget was based on revenues of K2,411 million and expenditures totalling K2,500 million. The deficit of approximately 1 per cent of GDP was to be funded by external borrowing.

29 The INA is a privately funded think tank with strong connections to the private sector. Primarily a private sector lobby group, the CIMC has very high level membership with Sir Mekere Morauta a former chairman and Sir Rabbie Namaliu a former deputy Chairman.

30 The Industrial Development (Incentives to Pioneer Industries) Act was repealed in order to stop the *ad hoc* extension of income tax incentives by Ministers to new companies.

rescind the changes of 1996. Capitulating to these pressures, the PNG government reverted to the previous forestry tax regime. While reversion to the older tax regime resulted in an almost immediate increase in log export levels, government revenue from the increase in log sales was negligible. All gains from the new tax regime were thus lost due to the PNG government bowing to pressure from private sector interests within the forestry sector (Levantis and Livernois, 1998: 67). This occurred despite protest from a number of NGOs, especially Greenpeace, who argued that the reduction in log export taxes did nothing for the country or the environment, serving only to improve the profits of log exporters and their political cronies³¹ (Vulum, 1999: 42-43). These events were not aberrations, however, as under the Skate administration many issues of public policy became increasingly orientated towards vested political interests. A large number of civil service and agency heads were replaced under the Skate government and a number of departments were downgraded, converted to statutory authorities, or amalgamated, all signals of increased political intervention in the bureaucracy (Yala and Levantis, 1998: 13). From July 1997 to the end of 1999 the PNG government dismissed 3 Central Bank Governors, 15 Departmental Heads and 38 Heads of Statutory and constitutional agencies. The negative impact of such heavy-handed political intervention was compounded by a lack of progress in another central SAP objective – trade liberalisation.

A Trade Liberalisation and Private Sector Development

Trade liberalisation was one of the key objectives of the 1995 SAP. Despite PNG's membership of organisations such as APEC, tariff levels in PNG continued to rise throughout the late 1990s.³² As part of the reform of indirect taxes specified under the 1995 SAP, the PNG government proposed the introduction of a simpler set of tariffs on imports.³³ With help from the World Bank the government had conducted a review of the tariff system in late 1995. After the tabling of that report in November 1995 the Chan government announced that a major reform of both the tariff and indirect taxation systems would occur. This commitment to reform was reconfirmed in the 1996 budget. A green paper on tariff reform was released in 1997, followed by a white paper the following year. The PNG government's White Paper on Tariff Reform made explicit the linkages between tariff reform and the commitment of the government to its continuing membership of APEC and the WTO. The tariff structures presented in these various papers became the basis of the tariff reforms passed by Parliament in September 1998. The tariff reforms, with their associated reduction in tariffs levels, were to be gradually introduced over an eight-year period. While this phasing in began in 1998, its progress has remained slow and erratic at best. While there has been a slight improvement on the trade liberalisation front, the extended time period over which these changes have come about diluted their original intent.

31 Interview with Mr Brian Brunton, Greenpeace, 24 November 1999 (Port Moresby).

32 In the March 1995 budget the Chan government had replaced all existing trade bans with tariffs, initially set in most cases at 40 percent. In 1998 the new Skate government placed a further 1.5 per cent drought levy on imports (Wesley-Smith, 1996, p. 430).

33 The introduction of a simpler tariff system was also consistent with PNG's position as a member of APEC. The objectives of the World Bank SAP were very similar in their nature to those of APEC.

The PNG government has, however, made a public commitment to trade liberalisation. This public image was further reinforced by the establishment of a National Investment Policy in August 1998 in order to make the government's investment policy consistent with the country's Medium Term Development Strategy and its continuing commitment to APEC.³⁴ The policy designed regulatory restrictions for investment and promoted greater transparency for the foreign investor. These goals were to be achieved through the strengthening of the IPA and the consolidation of its role as the co-ordinating agency for investment within PNG.³⁵ Yet despite such apparently positive steps towards attaining true trade liberalisation, in reality the PNG economy actually became increasingly regulated over the 1998-1999 period. The introduction of many SAP trade liberalisation policies was delayed under the Skate administration, including a two-year delay in the implementation of the VAT and the extension of the tariff reform programme from five years to eight. Moreover, the implementation of modified policies, such as the introduction of a needs-based tariff in 1998, actually went against the few reforms that had been successfully implemented. Much of the Skate government's policy-making in respect to the SAP objectives was questionable. Indeed, in open criticism of such lack of policy direction, private sector representatives began to speak of their lack of confidence in the government in late 1998 (*Post-Courier*, 29 August 1998: 3). Dissatisfaction with the direction of government policy was also expressed by other groups, with the trade unions being among the most vocal.

B Budget Troubles

When the 1999 Budget was finally tabled, the Budget deficit for 1998 was found to have grown to K187 million, close to 2.6 per cent of GDP and well over the expected 1 per cent deficit. The increase in the size of the deficit can be traced to a number of questionable budgeting practices over the previous year. Forecasting an overall Budget deficit of K80 million the new Budget was, like its immediate predecessor, overly optimistic. The substantial redirection of government spending towards certain priority areas (in accord with the 1995 SAP) was its stated objective, a goal to be achieved through spending reductions and offshore financing. The projections of government revenues forecast in the 1999 Budget, including a 12 per cent drop in recurrent expenditure, was to be achieved through the retrenchment of 6,500-7,000 employees. By August 1999, however, only 1,181 civil servants had been let go, while a further 2,693 had been declared redundant but were still awaiting their redundancy payments. This undesirable situation was made worse by the fact that, of those 3,874 civil

34 Interview with Simon Peter, Investment Promotion Authority, 22 November 1999 (Port Moresby).

35 The IPA was one of three government agencies designed to coordinate private sector investment. Set up in 1992 in an attempt to facilitate increased levels of foreign investment, the PNG government replaced the poorly performing National Investment and Development Authority (NIDA) with the Investment Promotion Authority (IPA) through an Act of Parliament. The main functions of the IPA were to facilitate all non-mining investment by certifying all eligible foreign investments and by establishing clear regulations for the registration process. This represented an attempt to streamline the process of foreign investment. Also established in 1992 was the Small Business Development Corporation (SBDC); its primary role was to promote the establishment and development of small businesses throughout the country. In a similar vein, the Industrial Centres Development Corporation (ICDC) was set up by the PNG government in 1993 to manage and operate industrial centres around the country.

servants, only 574 had actually been removed from the public payroll. In addition, in spite of the retrenchment programme 3,000 new employees were actually added to the public service payroll in 1999, highlighting the lack of coordination and integration existing within the PNG state in terms of personnel and business management. Additional problems with the 1999 Budget arose from the fact that tax receipts were forecast to increase by 11 per cent, yet tax receipts for 1999 ultimately proved to be about K60 million less than budgeted. In a similar vein, in order to reduce government expenditure provincial governments were assigned new functions and responsibilities but were not granted additional funds to perform them. Furthermore, in late February 1999 the government launched an initiative to privatise a number of state assets yet by July this had not progressed beyond the planning stage. This was despite the fact that government expenditure in 1999 was being based upon its receipt of K65 million from privatisation sales. Thus, by the end of June 1999 the fiscal deficit stood at a massive K200 million, already K120 million over that forecast for the entire year.

The retrenchment programme in the 1999 Budget came under almost immediate attack from the PNG Trade Union Council (PNGTUC), which opposed plans to scrap 15 government statutory bodies, agencies and committees.³⁶ The wide-ranging nature of these planned cuts led a number of other unions to join with PNGTUC, with many of them declaring strikes in late 1998. What began as a Communication Workers Strike in October over payment of their superannuation fund ended with a day's stop work action by the Air Traffic Controllers' Association in November in a show of solidarity with other unions as well as further threats of nation-wide strikes (*Pacific Islands Monthly*, 1999: 32). This increased public dissatisfaction was made most evident when a number of women's groups, representatives of NGOs and members of the general public joined forces with the trade unionists in a march on Parliament in November 1998. While the unions agreed to return to work the following month, the underlying tensions remained. These were further exacerbated when the government increased the level of MPs' District Support Grants from K300,000 to K500,000 a year in December 1998. Indeed, the rising levels of public dissatisfaction eventually led to the adjournment of Parliament in December 1998 for seven months in order to prevent the casting of a no-confidence vote by the opposition.³⁷ The adjournment of Parliament did not, however, stem the high levels of civil unrest. This continued to be expressed through various labour strikes and demonstrations as government spending on social services decreased.

C *A New Beginning*

The first few months of 1999, like those at the end of 1998, were characterised by wide public dissatisfaction with government mismanagement and corruption. The Catholic Archbishop of Port Moresby, backed by the PNG Catholic Bishop's Council, publicly

36 Interview with John Paska, General Secretary of the PNG Trade Union Council, 25 November 1999 (Port Moresby).

37 A 1991 constitutional amendment guarantees an 18-month period following a general election before a vote of no-confidence is permitted. In an attempt to avoid a no-confidence vote, as the 18-month grace period came to an end the Skate administration orchestrated an adjournment of Parliament.

announced his lack of support for the Skate government, calling for a change of government (*Post-Courier*, 1 April 1999: 1). Political machinations in Port Moresby meant that by July 1999 the Bishop's call had been answered. With the Skate government ousted, Sir Mekere Morauta took over the reins as Prime Minister. The new government immediately set about trying to ameliorate the damage caused in the first six months of 1999, seeking to provide some stability to the country's ailing macroeconomic environment. In August, in an attempt to ease fiscal pressure, a supplementary Budget was passed in which the new government committed itself to a number of objectives including focusing government expenditure on fewer priorities, stabilising the currency, containing inflation, removing barriers to investment, promoting private sector growth, and restoring the integrity of public institutions. The new Budget committed Morauta's government to increased fiscal discipline, the depoliticisation of the public sector, the stabilisation of the currency, and the construction of a macroeconomic framework conducive to private sector development.

VIII CONCLUSION

The 1995 SAP was effectively brought to an end with the ascension by Sir Mekere Morauta to the post of Prime Minister following Bill Skate's fall from power. While the monies lent to PNG under the auspices of the SAP are still owed to the Bretton Woods institutions, the signing of a new agreement between the incoming Morauta government and the World Bank in 2000 led to the creation of another, different matrix of structural reforms. The SAP was originally implemented in 1995 in order to restructure the country's governance structures so as to create a more resilient economic base. However, growth in the PNG economy continues to be powered by the mineral and petroleum sectors, effectively masking weaknesses in other sectors such as agriculture. In addition to the failure to address these issues of an economic nature, problems of administrative and political governance still abound. Frequent sackings of departmental heads have eroded the already tenuous independence of the country's bureaucracy, as have constant changes in the heads of statutory bodies and the questionable appointment of political cronies to various public bodies.

In spite of four years of reform PNG's political economy in 1999 was in many respects in a worse state than it had been in 1995. The 1995 SAP did little to improve the living standards of PNG's poor. The majority of the country's population is still illiterate and has limited access to safe drinking water, health facilities or public transportation. PNG's severe macroeconomic problems have led to the erosion of foreign exchange reserves, increases in inflation, and high interest rates. Large unbudgeted expenditures increased fiscal pressure on the government and led to further devaluation of the Kina. While predatory and corrupt behaviour was rampant under the Chan administration, political interference reached new highs under the Skate government, which at times seemed to operate with an almost complete disregard for the rule of law and which was a key reason for the continued deterioration of the country's economic situation. In the few rare cases where reform objectives were achieved, success seemed to depend more on the self-interest of central government politicians than on any altruistic desire to help the country. When reforms *were* achieved, the government had no compunction in repealing legislation when it no longer appeared politically expedient to maintain the reform impetus. The reversion back to the older forestry tax regime in 1998

was a prime example. Bowing under pressure from private sector interests, the reversion saw the loss of not only the short-term value-added benefits that the new forestry tax regime might have allowed but also the more long-term benefit of tax stability.

Reform programmes are always politically sensitive and governments will always be reluctant to implement politically unpopular policies. PNG's experience with the 1995 SAP is an example of these tendencies. The implementation of the SAP's objectives as a whole reads as a litany of successive failures. By any criteria the 1995 SAP was an abysmal disappointment, and provides a cautionary tale for Pacific politicians and public servants as well as for international financial institutions striving to bring about structural reform.

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