



Enclaves or equity

International Development
Issues No. 54

The rural crisis and
development choice
in Papua New Guinea

Summary



The Australian Government's
Overseas Aid Program

Enclaves or equity

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Australian Agency for
International Development

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ISSN 0818 4815

ISBN 0 642 76306 2

Published by the Australian Agency for International Development (AusAID), Canberra, November 2001.

The views expressed in this publication are those of the author and not necessarily those of the Australian Agency for International Development.

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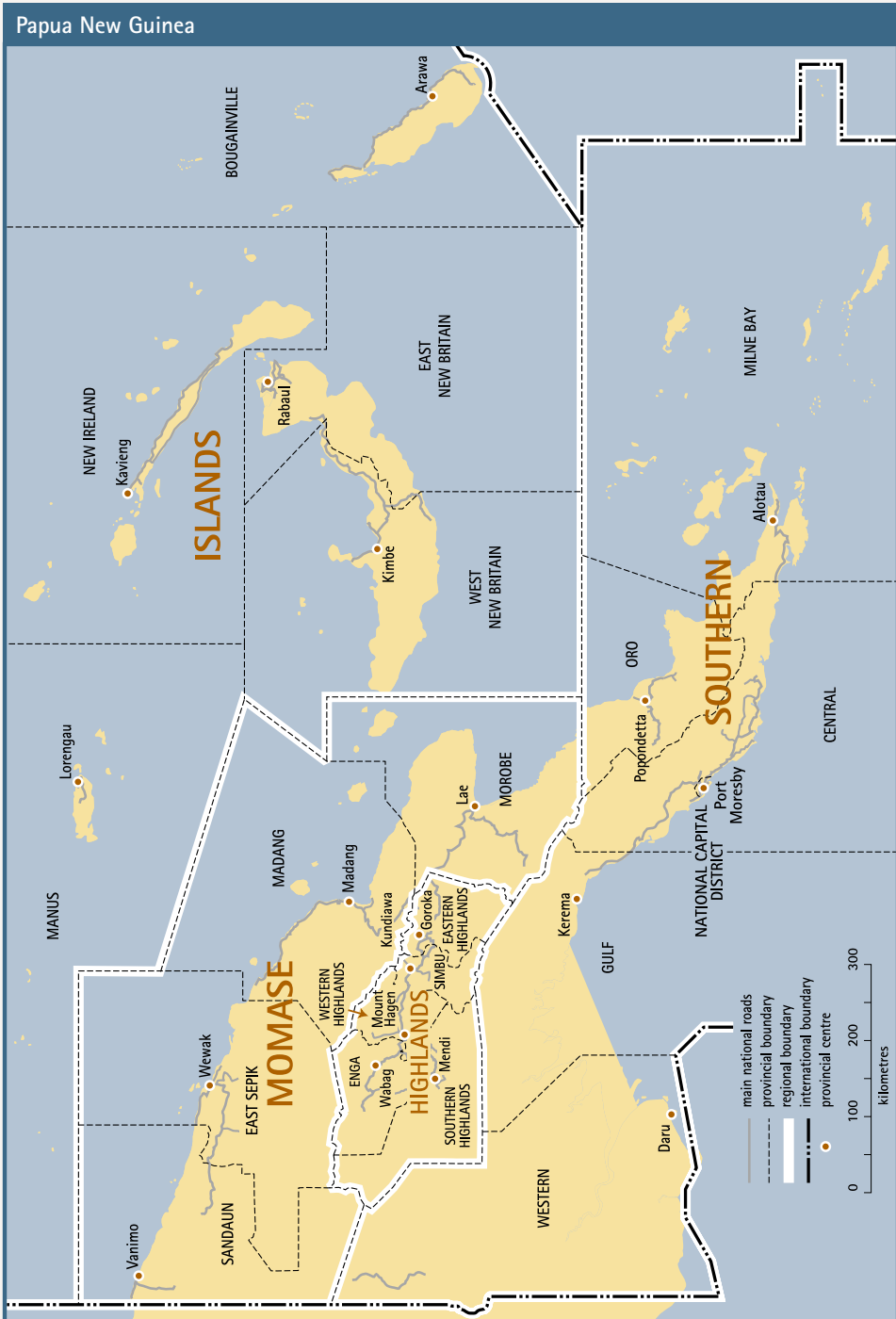
Produced by ByWord Services

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Photo of woodcutters on Mount Giluwe,
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Set in Rotis

Printed in Australia by Canprint Communications



Enclaves or equity

Rural Papua New Guinea is in a serious social and economic crisis. Overall in rural areas, living standards are worsening, the population is increasing rapidly, the resource base is being depleted, income-earning opportunities are decreasing, access to services and transport infrastructure is declining, the infrastructure itself is deteriorating and effective government support is uncommon.

There are rural areas with better living conditions – for example, those associated with resource projects and areas close to urban markets or other significant income sources. These exceptions, however, exist within a broad sweep of rural deprivation. The enclaves and the equity challenges they present epitomise the nation's rural crisis. Whether and how the crisis is addressed depends on the development objective – enclaves or equity – chosen by the Government and people of Papua New Guinea.

The rural crisis is in fact a national crisis. Links between rural and urban communities are particularly strong in Papua New Guinea because 80–85 per cent of the nation's 5.1 million people live in rural areas and the rural sector makes a significant contribution to the national economy. Failure to effectively address the crisis will have severe negative ramifications for the population and economy as a whole.

The crisis has built up over a long period. The need for effective intervention is now pressing.

- Public revenue could fall significantly in the coming 10–15 years as the mining and petroleum sector declines, leaving fewer public funds to address the crisis.
- Living standards in many rural communities are already poor and will get worse. This threatens to further destabilise the rural economy and make effective action more complicated and expensive.
- The longer the delay in addressing the rural crisis and the enclave and equity issues it encapsulates, the greater the damage that will be inflicted on the urban and indeed national economies.

Challenges and constraints

Papua New Guinea's social and economic indicators have improved from a low starting point at independence in 1975. However, significant social and economic inequity remains and just over a third of the population are living below the poverty line based on internationally accepted nutritional requirements.

The differences in living standards between rural and urban areas are dramatic. Living conditions in rural areas in general are poor; the rural poverty rate is almost three times that of urban areas, with 94 per cent of the poor living in rural areas.

Rural areas suffer from limited economic activity and opportunity, poor access to services, remoteness from urban markets, high-cost and deteriorating transport infrastructure, low and declining levels of public and private investment, a range of law and order and governance problems, and environmental pressures. They also face accelerating population pressure. Ignoring the possible consequences of an HIV/AIDS epidemic, an additional 1.3 million people will live in rural areas by 2010.

Rural people do what they can in the face of these challenges and constraints, but there is only so much they can achieve in the unsupportive context of current national economic policy.

Selected indicators of rural–urban differences		
<i>Indicator</i>	<i>Rural (minimum – maximum provinces)</i>	<i>Urban</i>
Economic		
Provincial government revenue per person, 2000 (K)	106 (Eastern Highlands) – 374 (Western)	514
Income per person, 1996 (K)	318 (Gulf) – 1829 (Western)	6 091
Radios per 100 people, 1996	21 (Sandaun) – 57 (Manus)	70
TVs per 100 people, 1996	1 (Southern Highlands) – 11 (Morobe)	61
Population with road access, 1995 (%)	11 (Milne Bay) – 97 (Southern Highlands)	100
Social		
Human development index, 1996	0.263 (Sandaun) – 0.473 (Western)	0.759
Poverty rate, 1996 (%)	41	16
Location of poor, 1996 (%)	94	6
Adult literacy, 1990 (%)	23 (Western Highlands) – 73 (East New Britain)	81
Life expectancy at birth, 1996 (years)	45.7 (Sandaun) – 57.2 (Manus)	60.5
People not expected to reach 40, 1996 (%)	33 (Sandaun) – 15 (Manus)	13
Underweight 5-year-olds, 1996 (%)	11 (Enga) – 41 (Sandaun)	10
Infant mortality per 1000 live births, 1996	37 (Manus) – 110 (Sandaun)	38
Access to safe water, 1996 (%)	4 (Manus) – 54 (Central)	92
Gross enrolment (elementary, primary & secondary), 1996 (%)	32 (Enga) – 67 (Manus)	46

Note: National Capital District is a proxy for 'urban' in all cases except 'poverty rate' and 'location of the poor'.

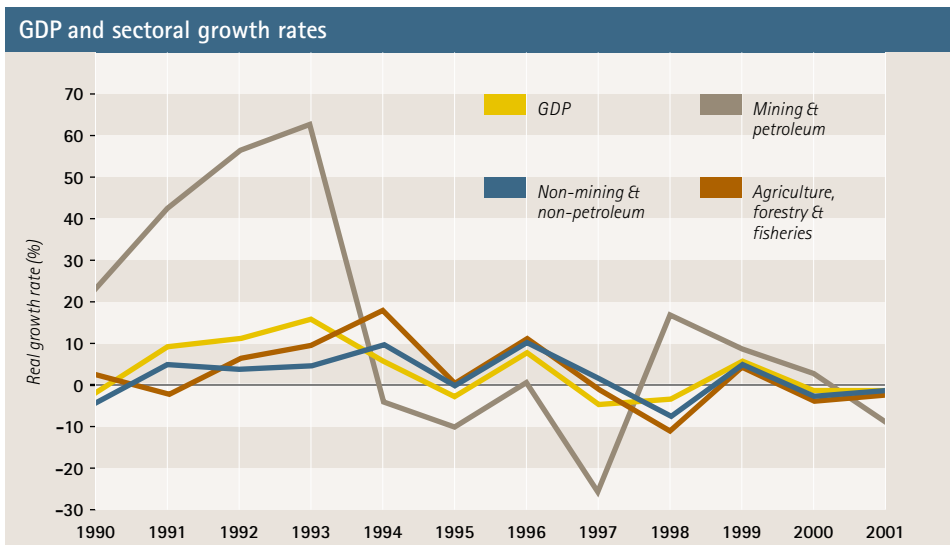
Sources: Data are from Office of National Planning, *Papua New Guinea Human Development Report 1998*, Office of National Planning and United Nations Development Programme, Port Moresby, 1999, except: 'provincial revenue' (from 2000 provincial budgets); 'poverty rate' and 'location of the poor' (from John Gibson and Scott Rozelle, *Results of the Household Survey Component of the 1996 Poverty Assessment for Papua New Guinea*, Department of Economics, University of Waikato and Food Research Institute, Stanford University, 1998); and 'provincial government revenue' (from provincial budgets).

The economy and the rural sector

Overall, economic policy and management in Papua New Guinea are dominated by fiscal and monetary concerns at the national level. Insufficient attention is given to growth and structural issues. The present Government has barely had time to do anything other than address economic management and political crises.

Despite strong efforts to improve the economic environment by reforming policies and institutions, the economy is very weak. Real gross domestic product is likely to be negative in 2001, and domestic and international confidence in the economy has collapsed. Both situations augur poorly for rural areas as much as for the nation as a whole.

Few of the policies that usually distort prices and incentives in the rural sector exist in Papua New Guinea. However, other aspects of economic management adversely affect the sector. These include liquidity crises, inappropriate expenditure patterns (including overemphasis on recurrent costs and inadequate attention to investment), poor budget management and the impact of low growth on public finances and demand. The underfunding of services and infrastructure in rural areas, as well as the failure to effectively address longstanding concerns for rural communities about governance and the investment environment, suggest an antirural bias in public policy.



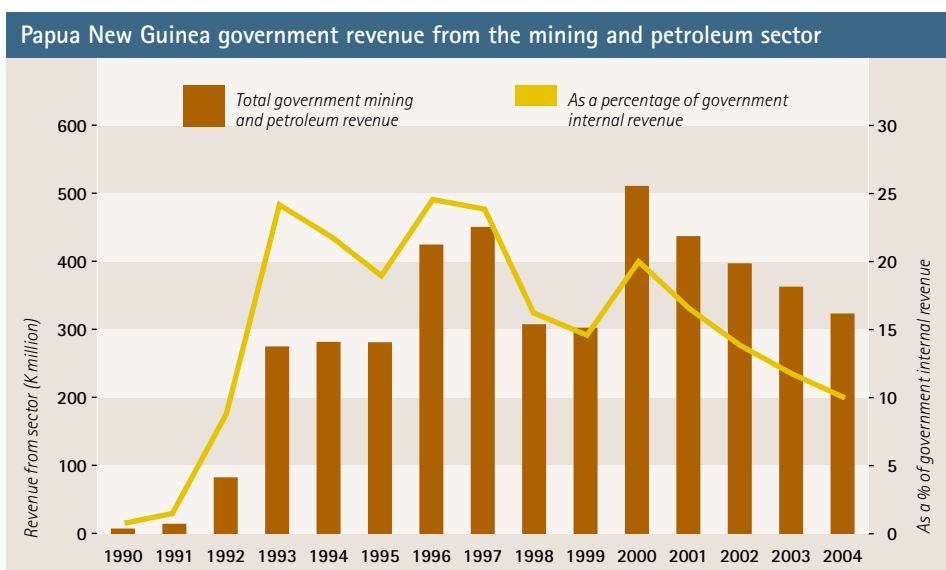
Note: Data for 2000 are provisional and for 2001 are estimates.

Data sources: International Monetary Fund, *Papua New Guinea: Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria*, Washington, DC, 7 September 2001, table 18, and World Bank, *Papua New Guinea: Improving Governance and Performance*, Report No. 19388-PNG, World Bank, Washington, DC, 1999, table 1.2.

The formal economy is dominated by the mining and petroleum sector. In 2000 this sector contributed 21 per cent of gross domestic product, 77 per cent of exports and about 33 per cent of government internal revenue. It faces serious challenges, not so much because of a lack of prospectivity but because of the unattractive investment environment.

The mining and petroleum sector appears to be in the early stages of decline. This is suggested by its negative real growth in four of the past eight years, the sharp decline in exploration, the failure so far to finance two pending major projects, the general decline in its revenue going to government, and the projected closure of all existing mines and oilfields by 2014 (although at one gold mine the processing of ore will continue for 13 years after that date).

The decline of the sector will have major repercussions on public finances, which will affect all aspects of the economy. At the very least, it will require the Government to comprehensively review its revenue and expenditure policy, and indeed to review its entire development strategy as the sector's revenue has facilitated recurrent cost expenditure patterns that are otherwise unsustainable.



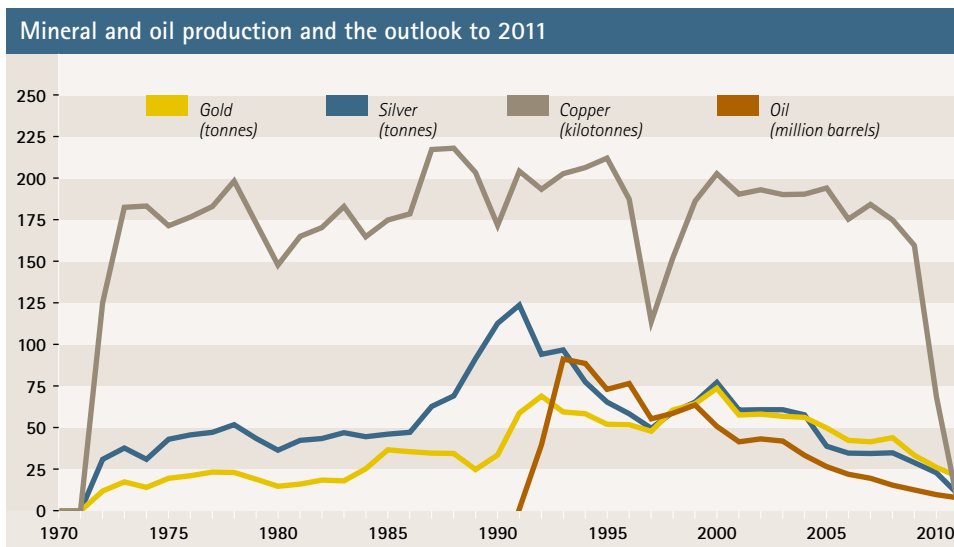
Note: The mining and petroleum revenue is composed of mining and petroleum taxes, Mineral Resources Stabilisation Fund dividend and payments (until 1998), mining levy (from 1998) and mineral and petroleum dividends (from 1999). Data for 2000 are estimates; data for 2001–04 are projections. Not included in this figure are the sector's contribution to government internal revenue through duties, royalties, salary and wage tax, withholding tax and the tax credit scheme; these contributions are equal to about half of the revenue noted in the figure.

Data sources: Bank of Papua New Guinea, *Quarterly Economic Bulletin*, Port Moresby, various issues; Government of Papua New Guinea, *Budget 2001*, Port Moresby, 2000.

The decline of the mining and petroleum sector may not occur in the time frame suggested, particularly as new oil finds and the funding of the PNG–Queensland gas project could quickly strengthen the sector and its contribution to the national economy. Even if that were to be the case, the economy’s reliance on the sector raises questions about whether the public revenue it generates is being used effectively for the long-term benefit of the economy. After all, by definition non-renewable resources, such as minerals and hydrocarbons, must eventually be exhausted.

There is little to show among the vast majority of the population who live in rural areas that the revenue generated by the mining and petroleum sector has been used effectively or is being used to increase productivity in those areas. This is despite the fact that the rural sector should become a main source of growth in the economy before the mining and petroleum sector does eventually decline.

Renewed awareness of the limitations of relying on the mining and petroleum sector, concern about how the public revenue derived from the sector has been used over the past 30 years, and the current rural situation provide an opportunity to rethink the development choices confronting Papua New Guinea.



Data sources: Papua New Guinea Chamber of Mines and Petroleum; Papua New Guinea Departments of Mining, and Petroleum and Energy.

Toward a strategy to deliver growth and equity

The rural crisis should be addressed not only in the interests of equity and of improving the social and economic conditions of the majority of the population, but because rural areas have a crucial role to play in Papua New Guinea's development. It is inconceivable that the long-term development of the nation can take place without effectively addressing the role and needs of rural areas given their social, economic and environmental functions. Growth in the rural sector is a necessary condition for long-term, broadly based economic growth in Papua New Guinea.

On paper, many government policies do give priority to rural areas, but they have not been successful. There are numerous reasons for this, including diffuse development objectives, inefficient and distortional budget management practices, and the failure of public resources to reach rural areas in significant amounts.

A strategy for rural sector growth could be built on principles that:

- adopt a clear, limited role for government to address equity and efficiency in the rural sector and to support – not duplicate – the role of the private sector
- encourage the informal sector throughout rural and urban areas
- give priority to establishing growth in real gross domestic product in the rural sector, but do not ignore the need to also provide critical services and social investment, such as education and health care
- address poverty directly and tackle gender constraints to development
- approach financing imaginatively and openly, giving priority to public expenditure where counterpart resources are provided and acceptable financial management systems are operating, and
- make difficult choices, avoid wasteful practices and establish priorities and a sequence for interventions.

Actions to address the rural crisis

To address the rural crisis, and the enclave and equity issue in general, three general steps could be taken by the Government and people of Papua New Guinea.

- First, design and implement a strategy to improve rural livelihoods.
- Second, make better use of financial, natural and human resources.
- Third, encourage donors to take on new roles and responsibilities to strengthen their contributions to development in Papua New Guinea.

In addition to these broad steps, and consistent with them, a number of actions could be taken now to start the process.

Investments – to be led by government

1 Develop marketplaces and expand their functions

Expand the facilities and functions of urban and other produce marketplaces to cater for greater numbers of farmers and other vendors, to encourage the sale of a wide range of household goods by farmers and informal sector traders, and to be service centres for government, non-government and commercial agencies.

2 Strengthen the means and content of communication for rural communities

Produce and distribute oral and written material on governance, social, health, technical, financial and business matters for rural inhabitants. The main distribution channels for the material would be government and other services located in marketplaces, and revamped national and provincial public radio services.

3 Prioritise road and port development

Prioritise investment in the transport sector to maintain and construct selected roads and ports in the active commercial hinterlands of major urban centres. The extent of this investment should be based on resources available in the medium-term fiscal framework, with due priority given to capital over recurrent costs and the sustainability of all proposed investment.

Policy – to be implemented by government

4 Set and implement targets for recurrent or capital expenditure as well as for rural or urban expenditure

Set annual targets for recurrent or capital expenditure and for rural or urban expenditure for investment and service provision in national, sectoral and provincial budgets, and implement them.

5 Improve budget management

Improve budget management in the near term by giving attention to the timely and predictable release of funds, the full integration of the Social and Rural Development Grant and the Province/District Support Grant in the provincial budgetary system, and the aggressive use of counterpart financing resources.

6 Encourage development of the informal sector

Encourage development of the informal sector, especially in trading, retailing, manufacturing and services, by removing restrictions on its development and ensuring that government policy and material assistance create an enabling environment for it.

7 Resolve important longer term policy issues

Resolve four longer term policy issues: the enforcement of the Public Finances (Management) Act, the implementation of the Organic Law on Provincial Governments and Local-Level Governments, the use and management of public revenue derived from the resources sector, and land mobilisation.

Initiatives to be taken by donors

8 Promote broad-based economic growth

Allocate a reasonable share of donor support to promote broad-based economic growth, in addition to support for social development and governance.

9 Ensure sustainable expenditure patterns

Ensure that donor programs do not encourage or require levels of recurrent cost support that are inappropriate to the medium-term fiscal framework.

10 Choose activities and resource transfer mechanisms to maximise impact

Choose activities and resource transfer mechanisms that maximise expenditure and impact in Papua New Guinea. Priority should be given to activities that support investment rather than recurrent costs and that entail expenditure on local costs and management through Papua New Guinea administrative systems.

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Rural Papua New Guinea is in a serious social and economic crisis. The Government and people of Papua New Guinea can no longer avoid the challenge of addressing the crisis – not only in the interests of equity and improving the conditions of the majority of the population, but because rural areas have a crucial role to play in the country's development.

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