

BEING HEARD

**The Results of the 2017 Survey of
Businesses in Papua New Guinea**

INA Discussion Paper 105

Paul Holden with Paul Barker and Steven Goie
INSTITUTE OF NATIONAL AFFAIRS
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- The Results of the 2017 Survey of Businesses in Papua New Guinea

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A Summary of the Survey Findings

- Responses to the survey provide little evidence that the businesses environment is improving. PNG remains a challenging country in which to do business.
- The biggest change since the 2012 survey is the difficulty resulting from the overvalued exchange rate and lack of foreign currency availability. Foreign currency practices by the Bank of Papua New Guinea are reported as being a major impediment to the effective running of businesses and are damaging future investment and growth.
- Security is a large burden on businesses, amounting to 10% of total operating costs and has had a negative impact on investment decisions.
- Business confidence in the judiciary has declined substantially over the past 15 years.
- The private sector regards government-business relations as weak.
- Private sector peak bodies are not perceived as communicating well with businesses regarding consultations with government.
- Corruption is becoming an increasing problem with most firms reporting that they make “irregular payments” to government officials.
- Government services are perceived as being poor by a majority of businesses; roads, bridges and electricity services are regarded as particular problems.
- Concerns remain regarding political stability although fewer firms reported being affected by it.
- The lack of stability of government policies have a negative impact on most businesses.
- Few PNG firms outside the natural resource sector export. In the long run this will have a negative effect on the competitiveness of the PNG economy.

Chapter 1: Background

1. Commencing in 2002, a cross section of businesses in Papua New Guinea has been surveyed at 5 year intervals on key factors in the business environment in PNG and the problems and challenges that the private sector faces. This fourth, and most recent survey, was conducted in the second half of 2017. This document reports on the issues identified by the participants and compares their responses to the results of earlier surveys. The continuity of the surveys provides insights into how the business environment has evolved.

2. The report commences with a brief overview of recent developments in the economy, to provide the economic context within which the survey was conducted. It then summarises some key conclusions of the earlier surveys. A discussion follows of the sampling processes and the key issues on which the survey focused. Each of these is then discussed in some detail. Where relevant, the answers are decomposed by sector and by business size. There are text boxes on the productivity of state-owned enterprises in PNG and on the issues connected with the impact of foreign exchange rationing on businesses. The overall findings are then summarised in a conclusion along with recommendations for reform priorities.

Recent Developments in the Economy

3. When the previous survey was conducted in 2012, the PNG economy was experiencing the benefits of a resource boom, as GDP growth was accelerating – over the 2014/2015 period, PNG's real GDP growth was one of the highest in the world. However, high growth came to an abrupt end in 2016. The 2017 survey was undertaken against a sharp slowdown in the economy as investments in the natural resource sector declined, and the international prices of many major commodities collapsed. The private sector has had to adjust to a precipitous decline in the growth rate of GDP. Furthermore, the IMF projects no more than very moderate growth over the next few years. At the same time, the public sector debt has risen at an accelerating rate, and the IMF projects that compared with 2013, by the end of 2018, the external debt to GDP ratio will have risen by 60%.

4. Public finances remain strapped for revenue, since mining/petroleum taxes have declined from K864 million in 2014 to K92 million in 2016 and a

projected K113.6 million in 2017. Mining/petroleum dividends also declined to K300 million in 2016. However, they increased to K562 million in 2017, partly as a result of the restoration of production at the Ok Tedi mine¹.

5. Inflation has moderated slightly but is projected to increase in 2018-2019. Interest rates on Treasury Bills have risen because of the need to finance the budget deficit. International reserve holdings have not declined further after falling sharply in 2015 and 2016. The size of reserve holdings may be misleading, however, as there is a significant demand overhang for foreign exchange - businesses report that foreign exchange to pay for imports is rationed and it can take weeks, or even months to obtain foreign currencies to settle import bills. This points to an overvalued exchange rate, something that the IMF flagged in its 2017 Article IV consultation report.

6. Since the last survey, the structure of the economy has also changed dramatically. In 2012/2013, non-renewable natural resources² constituted 13.6% of GDP. In 2017, it is estimated that this share had risen to 23.3%. This clearly has had substantial distributional effects, not only on the structure of the economy, but also on relative prices, the balance of payments, the exchange rate and investment opportunities. PNG businesses have had to adjust to the effects of these changes since the previous survey in 2012.

Chapter 2: Private Sector Views on the Business Environment Identified in the 3 Previous Surveys

7. The 3 previous surveys showed that while there was an improvement in the business environment over the 10 years surveyed, in all sectors, most companies regarded PNG as a challenging place in which to do business. Over the 10 years, there were some changes in the issues perceived as creating the greatest obstacles to investment and entrepreneurship, but in general many of the issues identified in 2002 were still regarded as significant problems in 2012. The identified constraints were:

- Business security and law and order, with low confidence in enforcement agencies and the judiciary. Most businesses employed private sector guards and security companies and indicated that crime and security

1. ¹Volume 1, 2018 Budget, Economic and Development Policies, November 2017 and Final Budget Outcome Report, March 2018, Department of Treasury

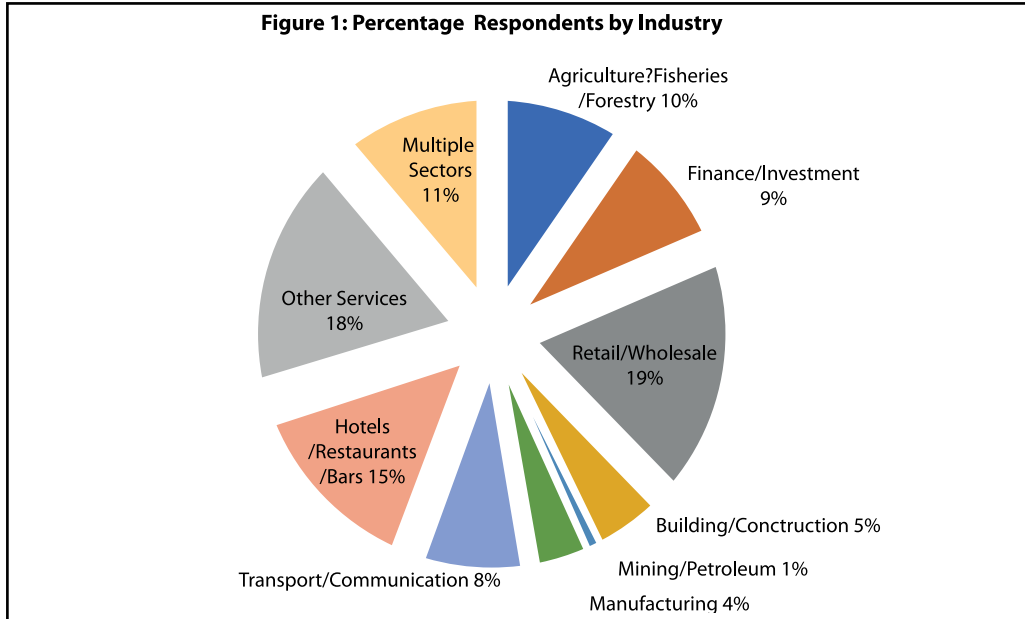
² Consisting of mining, quarrying, oil and gas

- measures imposed significant costs on their businesses;
- Government business relationships were identified as being a significant issue, with many of those surveyed indicating that they found public sector employees to be unhelpful. Many businesses reported that corruption was becoming an increasing problem and a majority saying that they had to make “irregular” payments to public officials;
- Most businesses indicated that they believed that they were not fully consulted regarding prospective changes in laws and regulations. They also indicated that they were not kept fully informed by their representative bodies regarding the results of consultations with government.
- Infrastructure and infrastructure services were reported as constituting a major constraint, especially in the provision of electricity and transportation. The access and affordability of telecommunication services remained a major problem;
- Burdensome and complex regulations were a major deterrent to new investment. Many businesses complained that regulations and policies were changed without warning or consultation;
- Political uncertainty also impacted investment negatively, although its impact fell significantly between 2002 and 2012;
- On the positive side, businesses indicated that they had confidence in supporting institutions such as the Company Registrar and the Securities Commission as well as private professional bodies such as those that supported and maintained standards in law and engineering.

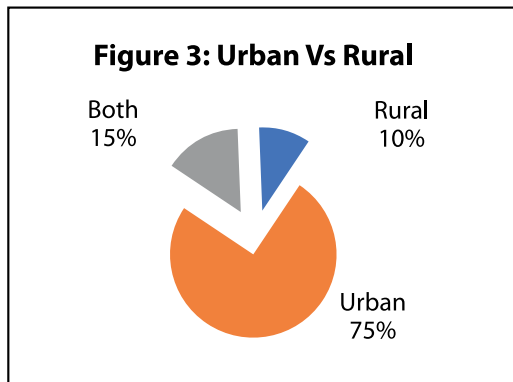
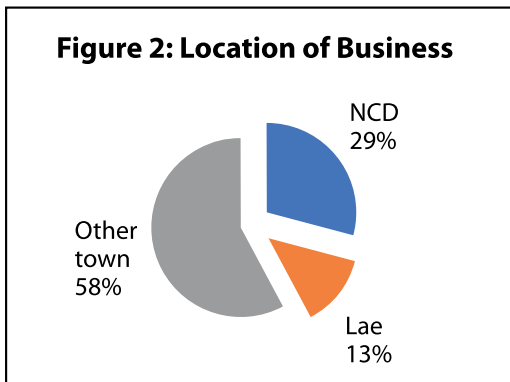
Chapter 3: The Survey Composition and Methodology

8. The survey was conducted between July and December 2017. There were 187 firms in the 2017 survey (compared with 136 firms in the 2012 survey). The respondents were drawn from a wide range of sectors and from 8 industry groups, plus a multi-sector group. Figure 1 shows the industry composition of the respondents. The largest sector responding constituted retail/wholesale businesses, followed by other services and hotels, restaurants and bars. Although mining and petroleum have grown sharply as a share of GDP, companies in this sector are among PNG’s largest, so they make up a small proportion of the total number of respondents.
9. The firms in the survey include locally owned businesses, foreign owned businesses and those with mixed local/foreign ownership. Care was taken to survey businesses not only in Port Moresby, but also those

Results of the 2017 Survey of Businesses in Papua New Guinea



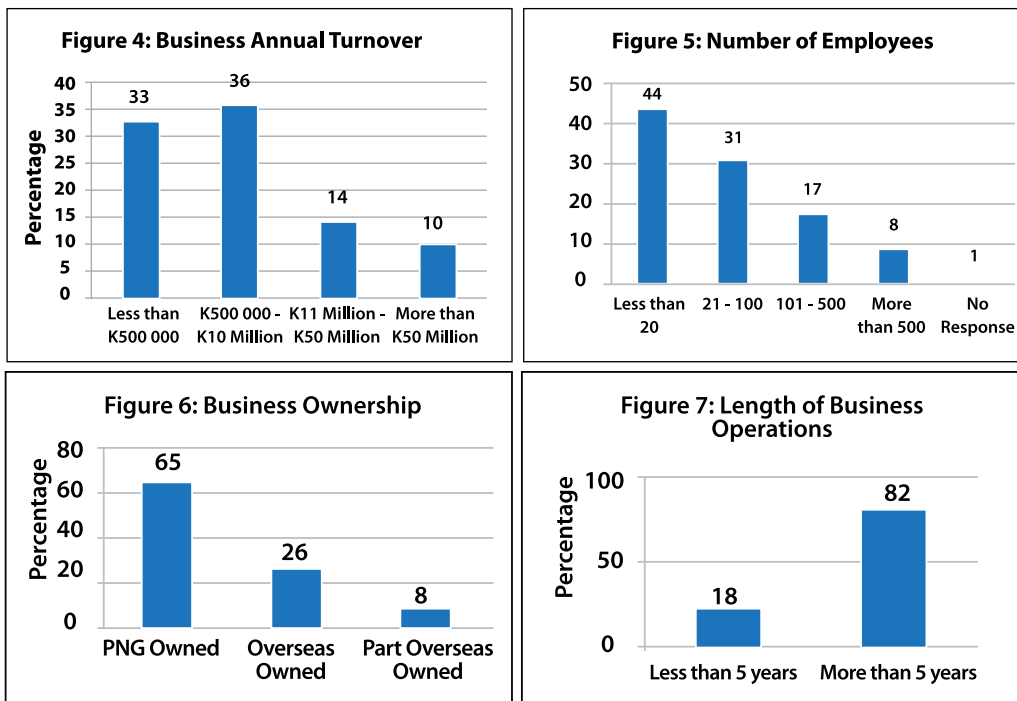
in other cities and towns. In addition, both large and small businesses were included to ensure that the views of SMEs were represented.³ All the firms surveyed were private companies, except for 4 state-owned enterprises. The location of businesses surveyed is shown in figures 2 and 3. Although only 29% were situated in the National Capital District, the majority indicated that they operate in urban areas. Most businesses in the sample are small or medium sized with 69% having an annual



³ Water PNG, Post PNG, PNG Ports and Ok Tedi Mining

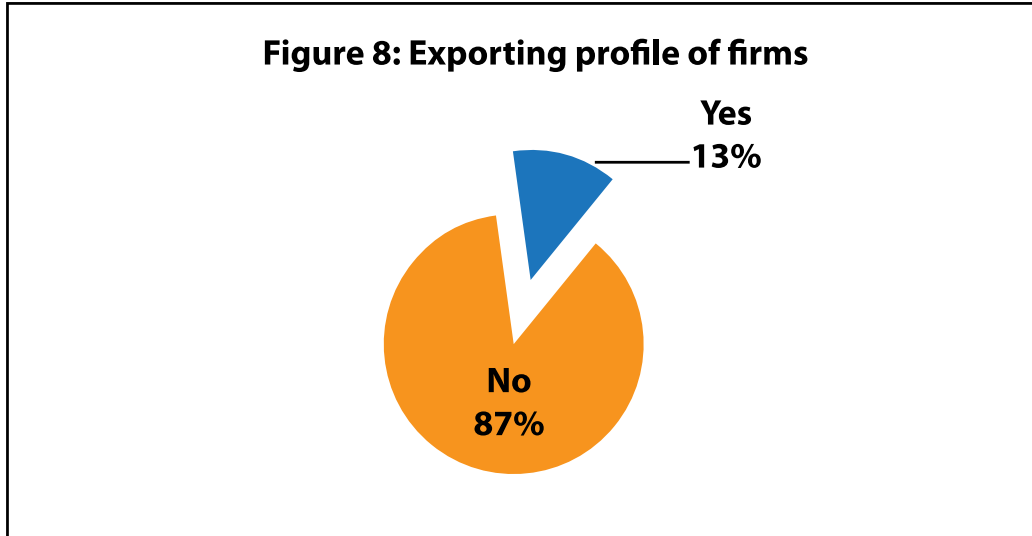
Results of the 2017 Survey of Businesses in Papua New Guinea

turnover of K10 million or less and 80% employing 100 or fewer workers (Figures 4 and 5).



10. The survey respondents had been in business for a relatively long time; over 80% indicated that their businesses were more than 5 years old. They were mainly PNG owned (65%) with 26% foreign owned and 8% with split PNG/foreign ownership (Figures 6 and 7).
11. Only a small percentage of the respondents indicated that they exported (figure 8). This could be a sign that the private sector in PNG lacks dynamism. There is substantial evidence that exporting opportunities have led companies to upgrade their efficiency, develop new product lines, increase marketing efforts and actively seek new markets. A survey of Pacific firms in 2014, (which did not include any from PNG) found that there was a substantial amount of exporting among Pacific island economies and that many of these exporters were small, with 20 or fewer employees. Among the exporters that were surveyed, size did not seem to be a barrier to engaging in exporting.⁴

⁴David Atkin, Amit Khandelwal and Adam Osman, 2017, *Exporting and Firm Performance; Evidence from a Randomized Experiment*, Quarterly Journal of Economics, May 2017, pp 551-615, demonstrates the positive impact of exporting on firm performance in terms of improved productivity and quality and positive spill-over effects on domestic production and knowledge transfer to local firms. See Paul Holden, 2014, *Export Dynamism in Pacific Island Economies*, Analysis of a Survey of Exporters for Pacific Trade and Invest for a discussion of the growth of exporting in Pacific island economies.



12. In the analysis that follows, the responses to the questionnaire are analysed to focus on details of the issues that are of concern to PNG businesses. Selected responses to the current survey are also compared with those of the previous 3 surveys to track how the private sector perceived PNG's business environment in 2017, compared with 2012, 2007, and 2002. This identifies areas where progress has been made and where the business environment has deteriorated. Although some questions have changed slightly, there is sufficient consistency in the design and methodology used to allow comparisons to be made with a significant degree of credibility.

Chapter 4: Results from the 2017 Survey

13. Businesses were surveyed on a wide variety of issues related to doing businesses in PNG. In order of priority, they were:

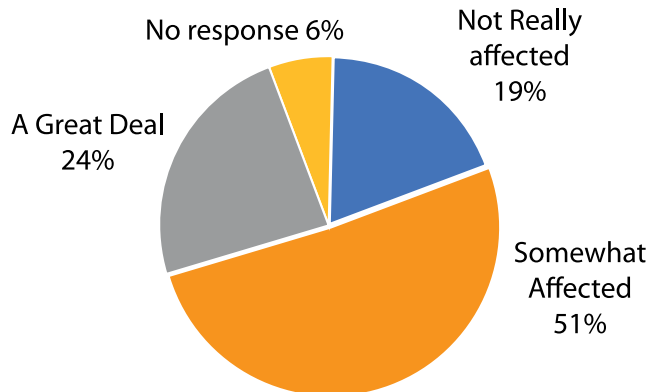
- Are they affected by government policies and regulations?
- How are they impacted by security issues related to their businesses?
- How do they perceive government business relationships?
- How effective is the provision of services by government and state owned enterprises and how does this affect their businesses?
- What in their view are the most significant constraints to doing business and undertaking investment?
- What are their key priorities for reform?

14. In the sections that follow, each of the main issues about which businesses were surveyed are discussed and analysed.

The Impact of Government Policies, Regulations and Politics on PNG Businesses

15. Many of the building blocks for a strong environment for private sector development involve actions by the State. Paradoxically, the State has a crucial role in promoting investment and entrepreneurship, not through direct intervention, but rather through establishing a strong commercial legal framework, a sound system for the enforcement of contracts, good infrastructure, the provision of basic services and limited but predictable and effective regulation.

Figure 9: Has the Instability of Government Policies and Regulations Affected Your Business?



| Table 1: Are you confident that announced policies will be implemented? | | | | |
|---|------|------|------|------|
| | 2002 | 2007 | 2012 | 2017 |
| Always confident | 1 | 1 | 2 | 2 |
| Mostly confident | 1 | 6 | 9 | 6 |
| Frequently confident | 7 | 9 | 14 | 10 |
| Sometimes confident | 27 | 37 | 31 | 33 |
| Seldom confident | 38 | 33 | 29 | 27 |
| Never confident | 26 | 13 | 14 | 18 |
| No response | 1 | 1 | 2 | 5 |

16. The confidence that policy announcements will be implemented declined slightly in the 2017 survey. Forty five percent of respondents indicated that they were either seldom or never confident that announced policies would be implemented. This indicates that there has been no improvement in the confidence regarding the implementation of government policies compared with 2007 and 2012, but is better than in 2002, when 64% of respondents indicated a lack of confidence

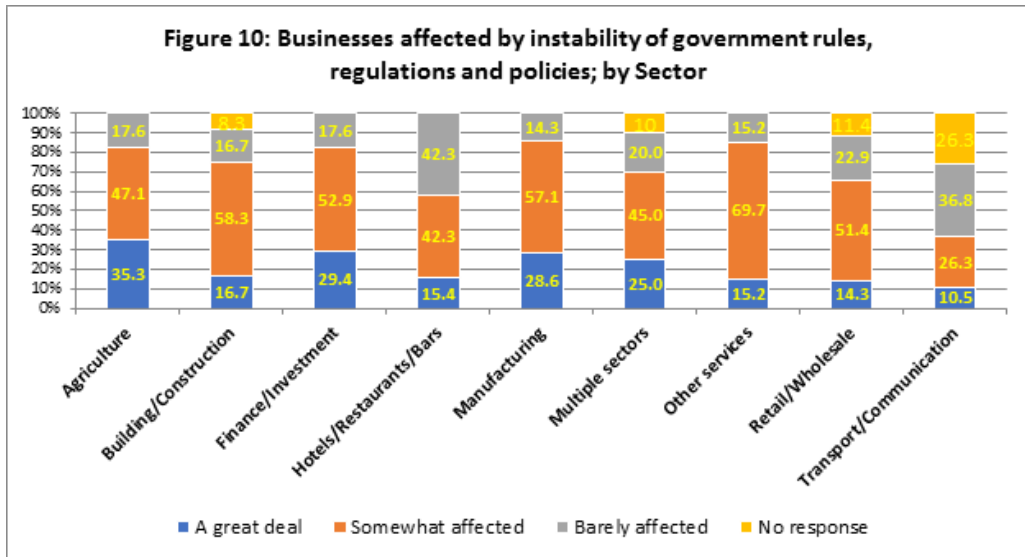
17. Businesses were asked to assess the impact of government policies and regulations on the running of their businesses and the effect that it had had on their investment decisions. An additional question was the extent to which policy and regulatory instability had affected them. They were also asked if political uncertainty, which had been a major issue in earlier surveys, was a significant concern in the light of the continuity of government over the last decade. Regarding policy and regulatory instability, 76% of all business survey indicated that they had been either a great deal, or somewhat affected by this issue (figure 9).

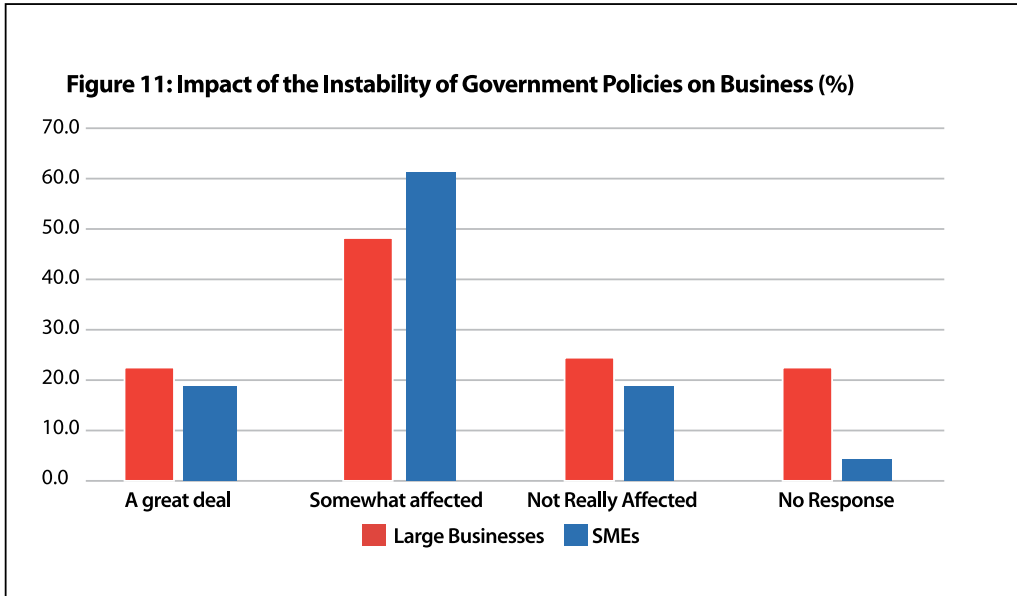
18. Respondents were asked if they either cancelled or did not proceed with business investments or contracts because of changes in policies or policy uncertainties. The replies indicated that policy uncertainty has taken a significant toll on the economy. There was a wide range of replies, with businesses in the hotels and tourism sector indicating that they had foregone investments ranging in value from K7,000 to K2 million. In agriculture investments of K5 million did not take place, while in construction, one respondent reported foregoing a K30 million investment or contract.

Results of the 2017 Survey of Businesses in Papua New Guinea

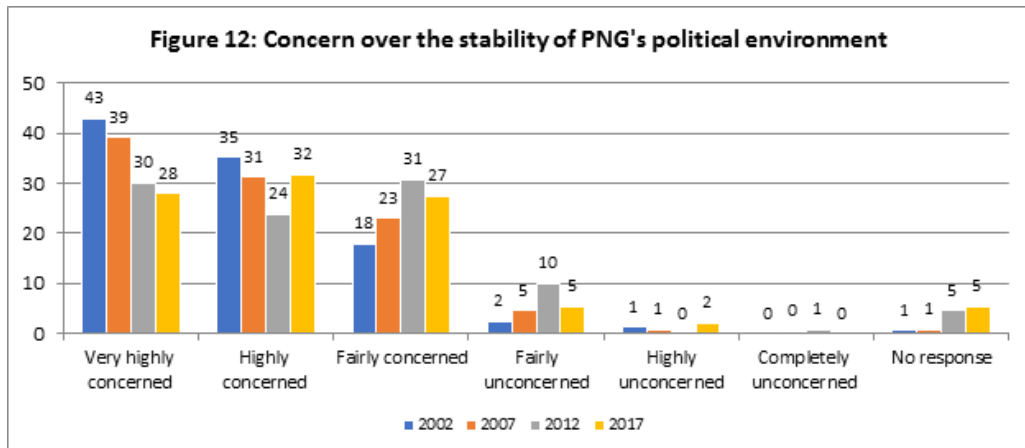
19. The extent to which each sector viewed this issue as important varied widely as shown in Figure 10. Respondents in the agricultural sector identified this as being of the greatest concern, with 35% indicating that it affected them a great deal. Since government has targeted the sector as one that it would like to develop further, consideration should be given to ensuring greater policy consistency. The manufacturing sector also identified the issue as being of significant concern.

20. The replies were disaggregated by size of business (Figure 11). While more large businesses reported being very affected by the instability of government policies (21% large businesses vs. 18% small businesses), SMEs reported by a large margin that they were somewhat affected by the instability of government policies (60% vs. 48%).

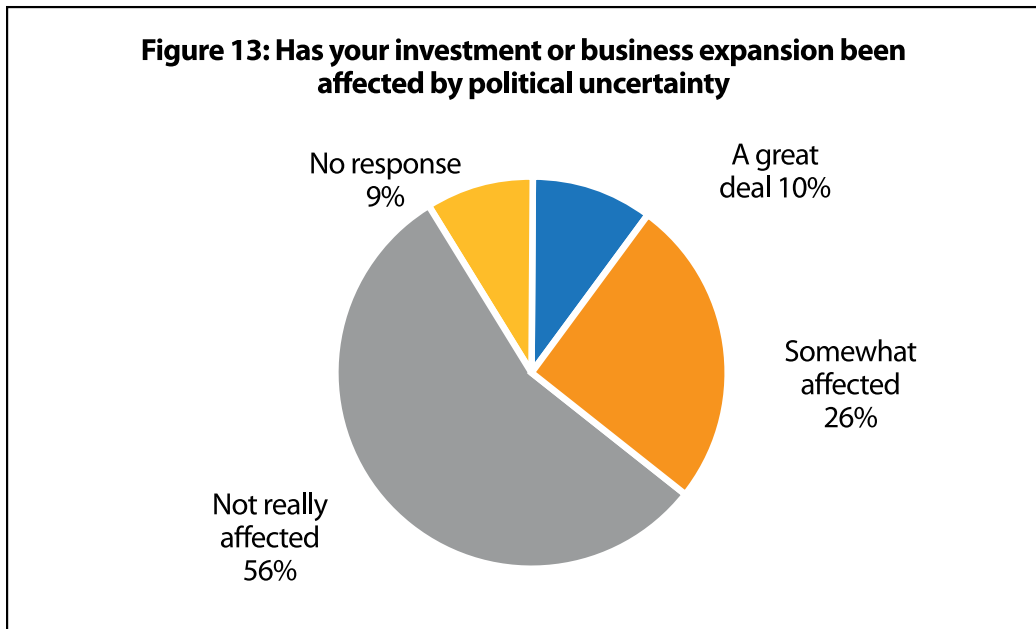




21. Surprisingly, after an extended period during which government did not change, a very substantial percentage of survey respondents expressed concern regarding political instability. Those expressing very high concern, or high concern increased compared with the 2012 survey (Figure 12). The responses may, however, have been affected by the survey having been conducted during and shortly after the 2017 elections.

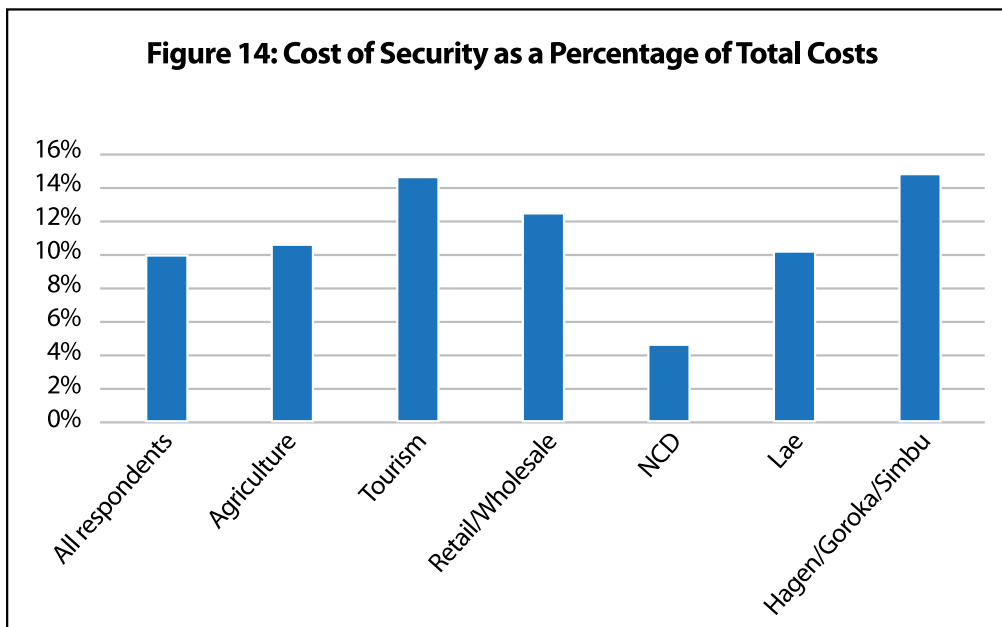


22. Although political uncertainty directly impacts business and policy uncertainty increases operating and investment risk, when asked if political uncertainty had impacted investment decisions or business expansion, over half said that it had not. Of those affected, 10% said that political uncertainty had had a substantial influence on their investment or expansion decisions, while 26% indicated that it had had some influence (Figure 13). While these latter 2 groups are in the minority, there is the possibility that expansion, investment and therefore business growth has been lost because of the perception of political instability.

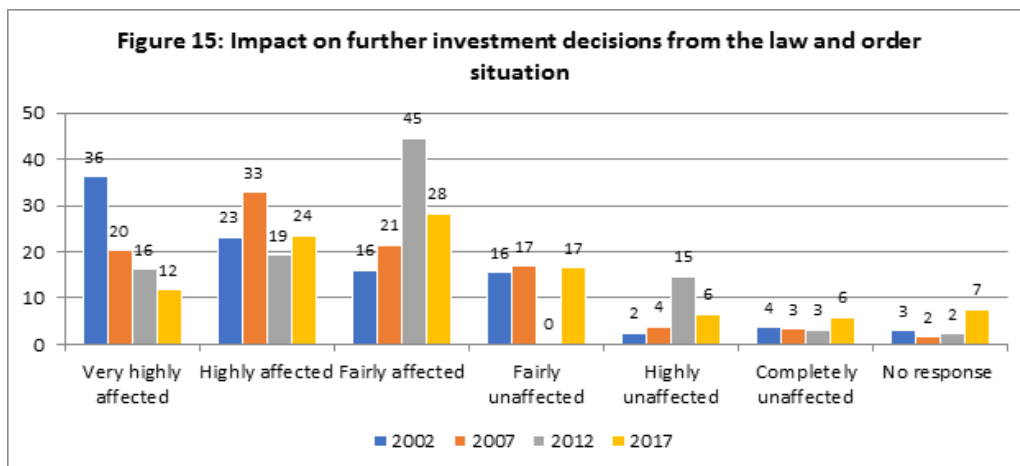


Law and Order

23. Numerous publications, reports and newspaper articles have highlighted the effect of crime on personal safety and business security. There are copious reports in PNG newspapers on theft of crops, inventory and cash. Trucks on highways are hijacked and looted, with these thefts often being violent. Shift work maximises the usage of capital and increases the productivity of assets, yet in PNG is rarely possible because of the threat of crime against employees. While many in PNG indicate that the threat to tourists is exaggerated and localised, the external perception in the tourist industry is that PNG is a dangerous place to visit, which reduces the advantages of the country's great natural beauty and cultural appeal.

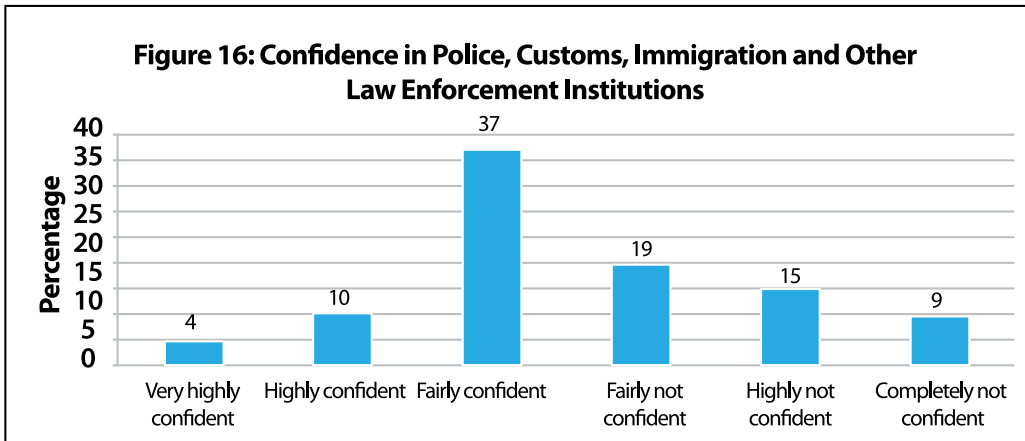


24. Furthermore, crime directed at businesses constitute a tax on doing business, with the more serious the crime problem, the higher the tax. In many cases, the amount spent on security can be as high as the average profit margin that firms earn. Respondents in the survey were asked to estimate the cost of security on their businesses as a percentage of all their costs (figure 14). On average, businesses reported that the cost of security, consisting of the cost of protecting their businesses plus losses from crime amounted to 10% of their total costs. The industry reporting the highest cost was tourism, while businesses located in the Hagen/Goroka/Chimbu area reported the highest costs from crime.



25. If there is one constant from the 4 business surveys over the past 15 years, it is the adverse impact of security and crime on the business environment. Each of the past surveys identified this issue as businesses' most pressing concern, and the 2017 results are no different. Law and order is one of the key public goods that governments should provide. In this regard, the State in PNG has failed and continues to fail.

26. In the 2017 survey, 64% of respondents indicated that the law and order situation had negatively influenced their investment decisions. While this represents some improvement over previous surveys, security issues are clearly still taking a significant toll on decisions to invest and expand. Figure 15 shows the evolution of concern for the impact of the law and order situation on investment decisions over the 4 surveys.



27. There is also a low degree of confidence in law enforcement bodies. Figure 16 shows that over 40% of the businesses in the survey sample expressed a lack of confidence in law enforcement. However, the evolution of responses indicates some improvement over time. In the 2012 survey, over 50% of those surveyed expressed lack of confidence in law enforcement bodies in answer to this question.

28. Confidence in the judiciary is mixed. The number of businesses expressing very high or high confidence was only 20%, which contrasts markedly with the 2002 survey when the equivalent statistic was 44%. Nevertheless, the 2017 responses represent some improvement compared with those in 2012, when

the equivalent number was 14%. Table 2 shows the evolution of businesses confidence in the judiciary over the 4 surveys.

| Confidence in % | 2002 | 2007 | 2012 | 2017 |
|--------------------------|-------------|-------------|-------------|-------------|
| Very highly confident | 21 | 5 | 5 | 3 |
| Highly confident | 23 | 12 | 9 | 17 |
| Fairly confident | 34 | 43 | 44 | 40 |
| Fairly not confident | 14 | 19 | 18 | 16 |
| Highly not confident | 5 | 12 | 12 | 8 |
| Completely not confident | 2 | 7 | 10 | 6 |
| No response | 2 | 0 | 2 | 10 |

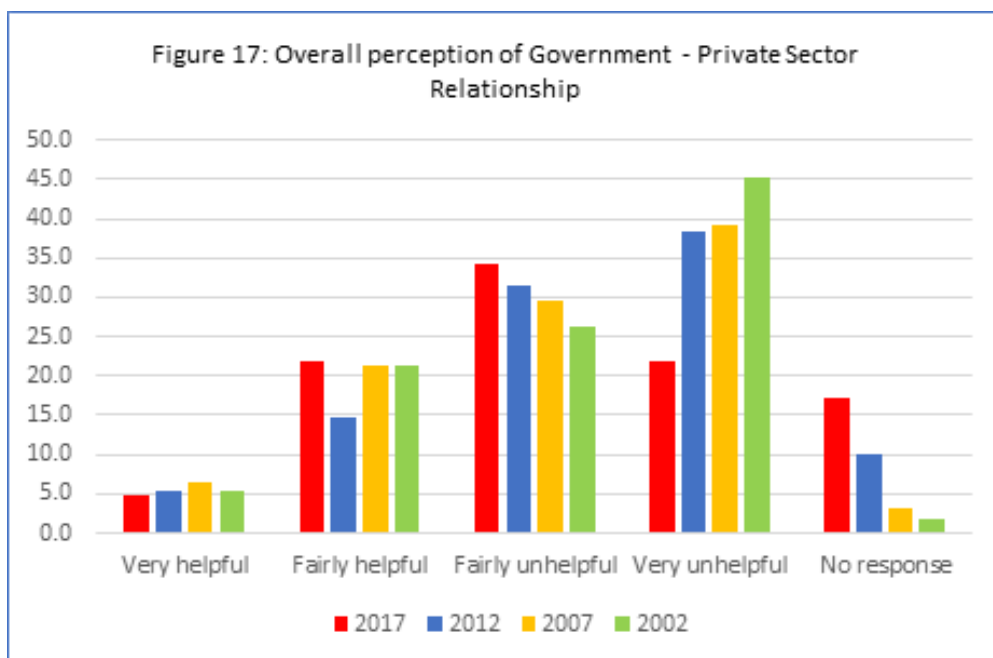
29. The judicial system is one of the most important institutions in any country, because it is responsible for ensuring criminal justice and it has a crucial role in the enforcement of contracts, the fundamental building block of business transactions. If businesses do not have faith in the sanctity and enforcement of contracts, their business and investment decisions will be riskier, and require higher rates of return. As a result, growth and productivity will be lower than it otherwise would be.

Government Business Relations

30. A vibrant private sector requires a strong, collaborative relationship with government. Ongoing dialogue with government ministries and institutions ensures that potential policy initiatives reflect the feedback from businesses regarding how their operations will be affected by new policy initiatives that impact the private sector. If business feels that it has a voice, it will be more willing to cooperate with the public sector and follow laws and regulations. At the same time, government should resist entreaties from businesses for special treatment that reduces competition or provides special treatment to sectors or individual businesses. Independent bodies, particularly non-profit institutions that are neutral, have a strong role to play in flagging poorly designed government policies as well as rent seeking behaviour on the part of the private sector.

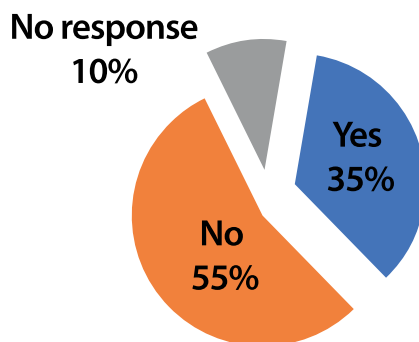
31. Businesses were surveyed on their perception of the relationship between the public and private sectors. Figure 17 shows the evolution of how

helpful businesses view government in the relationship with the private sector. It shows that there has been some improvement in this regard, with nearly 30% of respondents indicating that they perceive government to be either very helpful (5%) or fairly helpful (22%). This represents an improvement of several percentage points since the 2012 survey. Furthermore, there was a large decline in the number of respondents who viewed government as being very unhelpful – from 38% in 2012, to 22% in 2017. Nevertheless, when interpreting the improvement, the fact that over 50% of all businesses surveyed still view government as being either fairly unhelpful or very unhelpful remains a major concern.



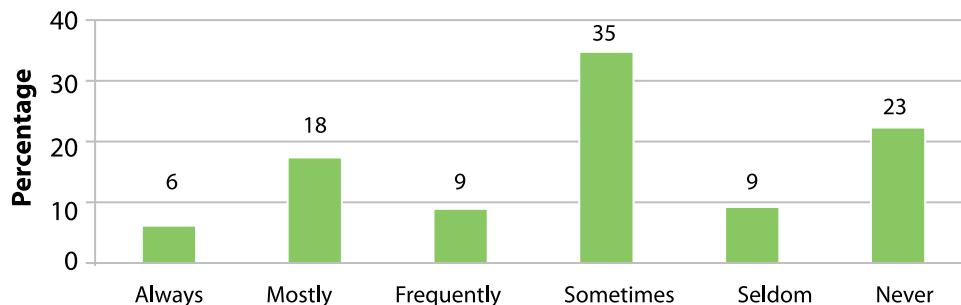
32. A feature of a strong business environment is consultations between government and the private sector over proposed policies. However, 55% of the survey respondents indicated that they were not aware of public-private sector consultations when government was developing policies and law reforms that would affect their businesses (figure 18). This indicates no improvement in awareness of the interaction between the public and private sectors. If the public and private sectors do not engage in dialogue, misunderstandings arise – the private sector will claim that it is ignored by government, while policymakers and government officials will maintain that they are doing all that is necessary to help businesses, but that their efforts are being ignored.

Figure 18: Business Awareness of Public/Private Sector Consultations in Developing Government Policies to Develop Private Sector



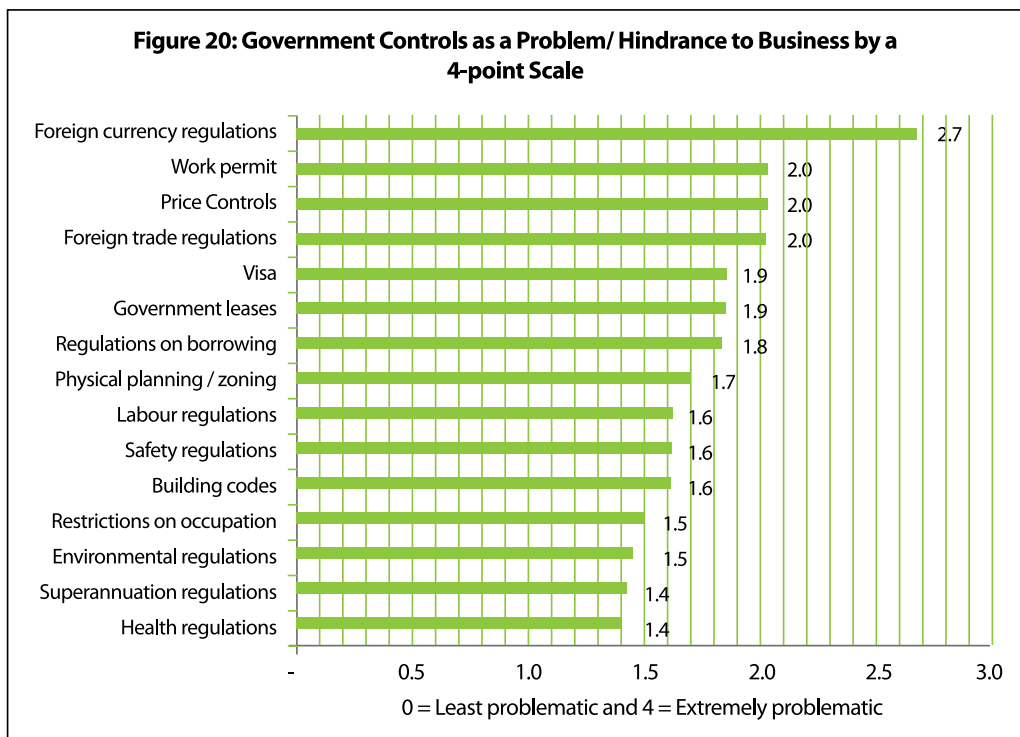
33. Furthermore, even among those businesses that were aware of public sector/private sector consultations, 67% of respondents indicated that they were not updated frequently on the outcome of consultations (figure 19). This indicates that not only are consultations between businesses and government an issue, but also that consultations within the private sector leave much to be desired.

Figure 19: Business Being Updated on the Outcome of Policy Consultations



34. Businesses were also asked to rank government policies and regulations as hindrances to their businesses. The rankings are shown in Figure 20. Foreign

currency regulations are regarded as the largest single issue, by a significant margin. This is the result of foreign exchange rationing by the Bank of Papua New Guinea. Importers are required to apply for foreign exchange to pay for their purchases of goods and services from other countries. Delays in obtaining foreign currencies can run into months, rather than weeks. This is a sure sign of a severely overvalued exchange rate. Furthermore, like efforts to defend overvalued exchange rates in other countries 35. PNG’s attempts to limit currency depreciation has resulted in an ongoing drain on foreign exchange reserves – US\$830 million in 2015 alone – without addressing the fundamental imbalances resulting from the overvalued kina exchange rate.



Text Box 1: International Monetary Fund Observations on the Kina Exchange Rate Policy.

The analysis and recommendations of the most recent 2 IMF Article IV Reports confirm the findings of the survey regarding the difficulties caused to PNG businesses by foreign exchange shortages. The IMF points out the consequences of attempting to defend an overvalued exchange rate through rationing of foreign exchange. “FX rationing has increased the risks of balance of payments problems, and hampered private sector investment by compressing

imports, discouraging non-resource exports, and impeding dividend transfers abroad.”^a Furthermore, the IMF found evidence that allocations of foreign exchange went to favoured importers, rather than being distributed neutrally. The IMF observed that “the current FX allocation mechanism poses risks for sustainability of the external position and could result in disorderly exchange rate adjustment.” It recommended “greater exchange rate flexibility and improved market efficiency and transparency [that] would reduce the cost of adjustment to lower commodity prices and curtail risks.”

The 2017 Article IV report observes: “The main impediment to private sector development is macroeconomic policies. The main obstacle to business activity and investment are difficulties in obtaining foreign exchange. This is adversely affecting both current activity and the willingness of parent companies to continue investing in PNG.”^b

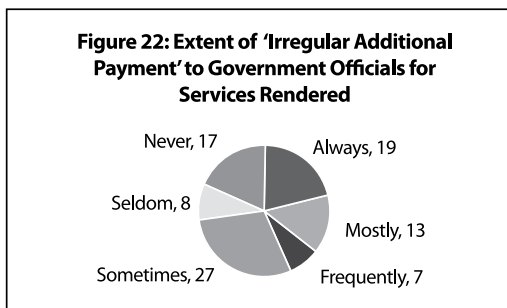
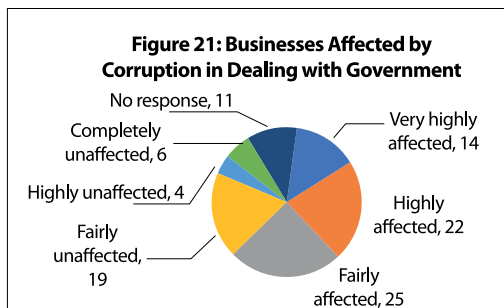
a. International Monetary Fund, January 2017, Article IV Consultation Report for 2016

b. International Monetary Fund, December 2017, Article IV Consultation Report for 2017

35. The most significant other impediments to businesses reported by respondents were price controls, foreign trade regulations, and work permits (figure 20). All of these provide opportunities for public sector officials to exercise discretion, which can lead to demands for “special payments” as responses to questions on this issue indicate.

36. A further issue with respect to government-business relations that the survey revealed was the problem of corruption in dealing with the public sector. Over 60% of the respondents indicated that they were either very highly affected, highly affected or fairly affected by corruption in dealing with government (figure 21). At the same time, 66% of respondents indicated that they made “irregular additional payments” to government officials (figure 22). About 40% of respondents indicated that such payments led to positive outcomes on a regular basis. However, less than 20% of respondents indicated that they regularly sought recourse when approached for irregular payments.

37. The extent of corruption reported by businesses appears to be widespread. While the greatest number of respondents indicated that the problems lay in either Lands or Customs/Finance/Tax institutions, these amounted to only 36% of total replies. Most respondents indicated that there were multiple institutions where irregular payments were necessary.

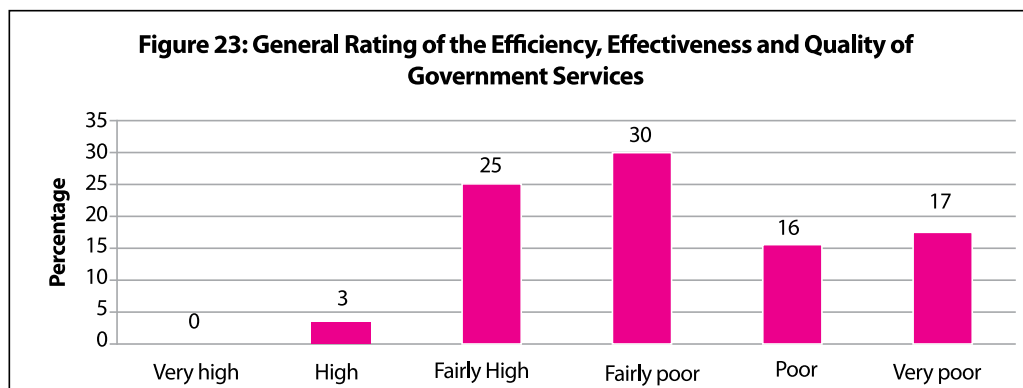


38. Corruption thrives when regulation is widespread and government official have latitude in their interpretation.⁵ As with crime, the need to make corrupt payments amounts to a tax on business, but also can distort resource allocation, with negative effects on productivity and investment.

The Efficiency, Effectiveness and Quality of Government Services

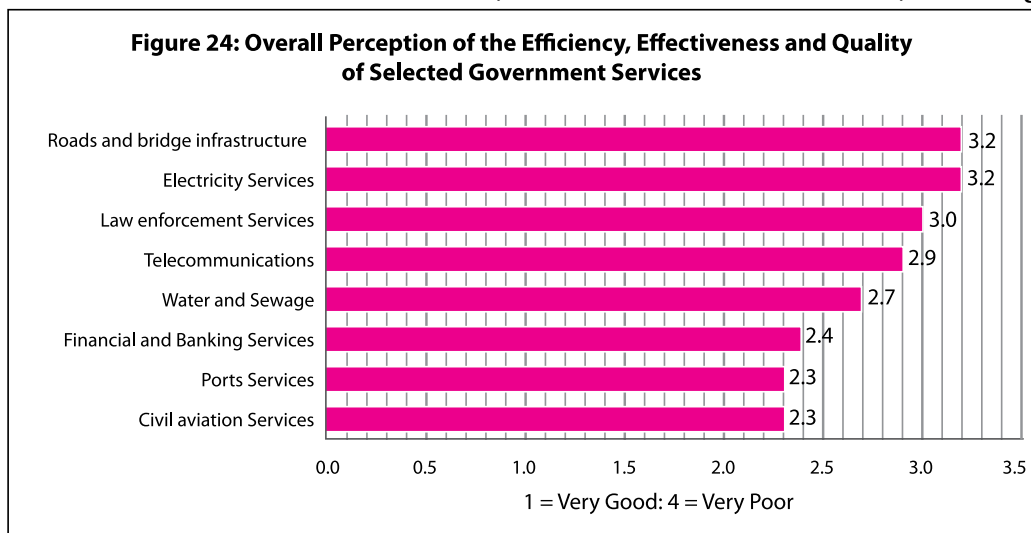
39. A business environment that encourages investment and entrepreneurship requires good quality infrastructure. In many high income countries, governments supply some infrastructure, such as roads, while the private sector supplies types of services for which it can charge, such as electricity, ports and airports. However, in the Pacific, government ownership of most infrastructure services remains the norm.

40. Businesses were asked about their perceptions of government services. No respondents ranked the efficiency, effectiveness and quality of government services as being "very high". By contrast, 63% of respondents viewed government supplied services as being fairly poor, poor or very poor (figure 23).



⁵See Paul Holden and Jennifer Sobotka, 1998, *Corruption: An Economic Perspective*, International Society of Social Defense; Conference Volume on Corruption, Milan Press

41. A further question asked businesses to rate the quality of services in specific sectors on a 4 point scale, with 1 being the highest quality and 4 the lowest. If 2 is taken as a neutral view, all the scores were above this, indicating



that the private sector view government services of being below even average quality. Highways, roads and bridges and, electricity services and law enforcement received the lowest rankings (figure 24). Telecommunications also received

Text Box 2: The Productivity of State Owned Enterprises in PNG.

A recent study on productivity of state owned enterprises in the Pacific region a found that PNG's SOEs are among the least productive. Using New Zealand as a benchmark, because it is a relatively small island economy, the results of the study indicated that PNG's SOEs were only 6% as productive as those in New Zealand. This cannot be explained by differences in capital investment. On average, capital/labour ratios in the region were about 50% of those of New Zealand companies analysed – if everything else was equal, this would imply that SOEs in the Pacific should be much closer in terms of productivity differences to those of New Zealand. Analysis of the productivity of PNG Power was hampered by the fact that publicly available information could only be obtained up to 2009, an indication that lack of transparency and accountability is a major problem. However, the productivity of PNG water was the lowest of all the water SOEs in the region.

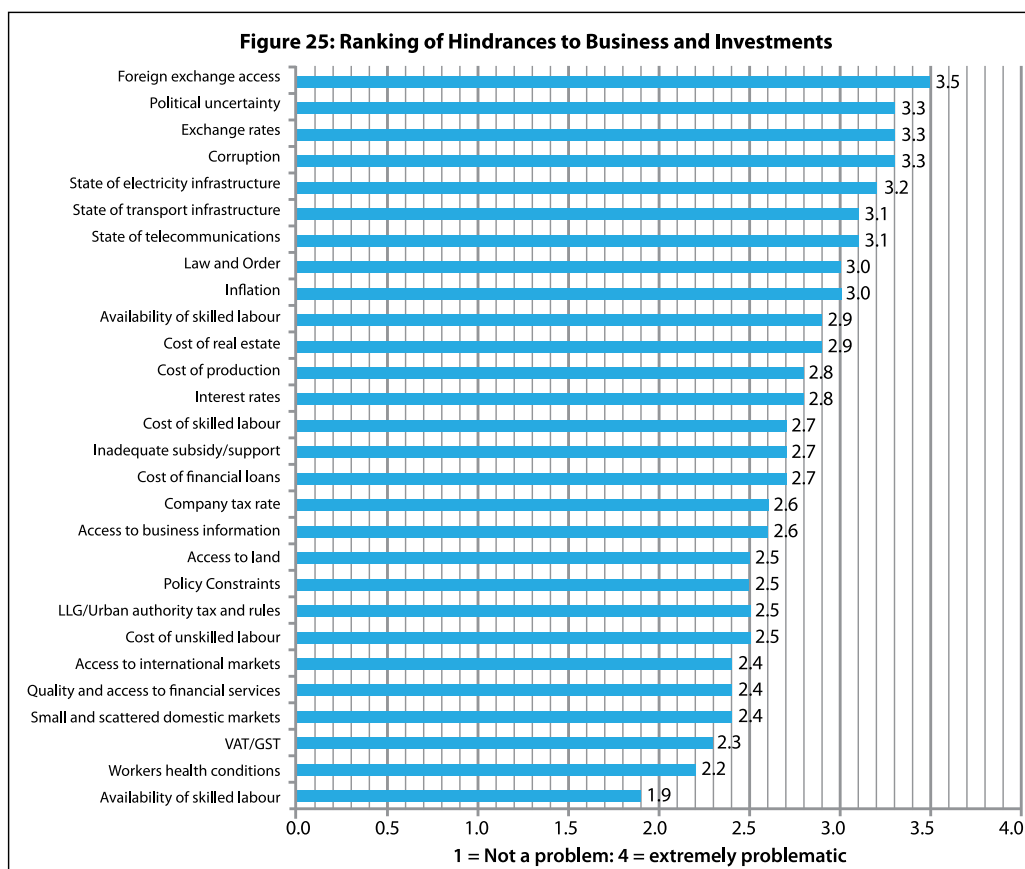
^a Paul Holden and Luis Guasch, *The Productivity of State Owned Enterprises in Pacific Island Economies*, 2017

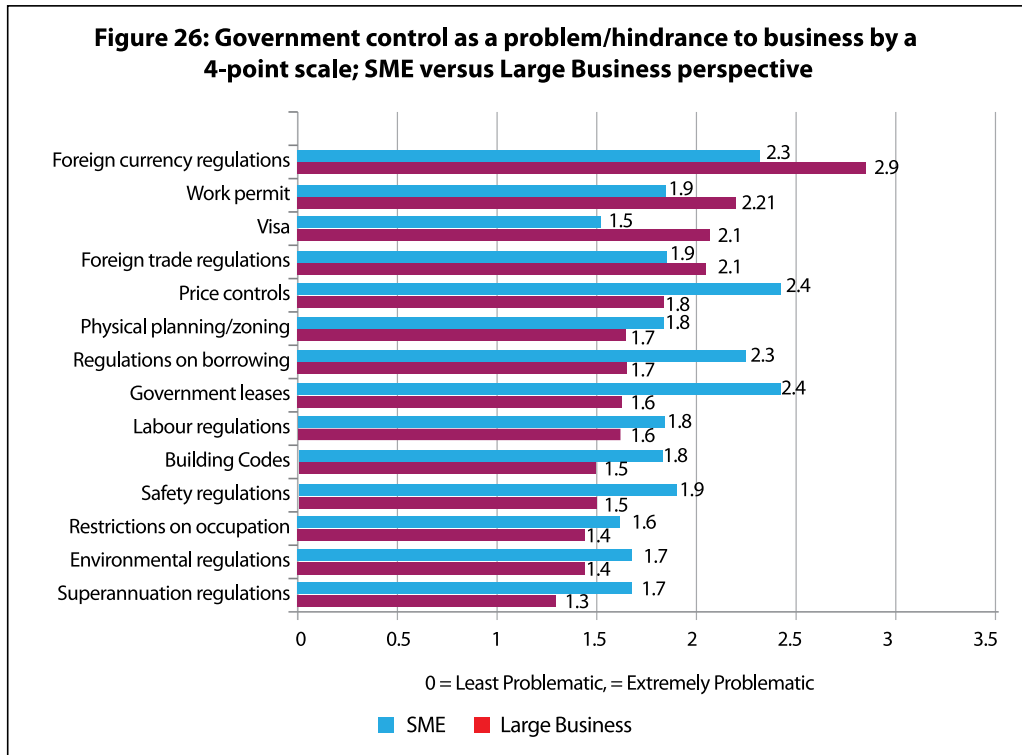
poor ratings, despite the explosive growth of mobile phones since 2007. This may well be because it remains costly to access the Internet, as well as the poor performance of state owned telecommunication providers, and the government monopoly on access to the Internet undersea cables (and the limited bandwidth of the aged fibre-optic cable to Port Moresby).

42. In general, the productivity of state-owned enterprises in PNG is very low (text box 2). Although, observers usually focus on the financial performance of SOEs, productivity is the key metric against which the performance of SOEs should be measured. While SOE deficits can be a major drain on the public sector budget, good financial performance does not account for the contribution of SOEs to growth. Financial performance can be enhanced when SOEs have a monopoly or receive favoured treatment by the State, such as in the provision of finance – neither of these contribute to growth. The true measure of the effectiveness of SOEs is determined by their productivity – in the long run, a country's prosperity is derived from increases in productivity, and therefore service provision, which is why the low productivity of PNG's SOEs is of concern and is imposing a substantial cost in terms of lost growth.

Chapter 5: Summing Up the Survey Findings

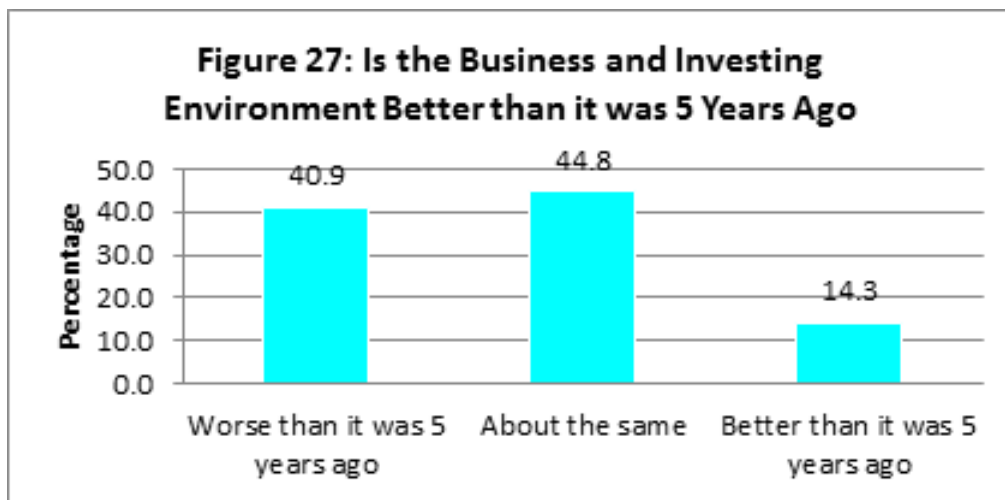
43. The overall ratings of constraints to business are shown in Figure 25. The responses support the findings of the earlier sections. The most significant constraint is perceived to be issues related to the exchange rate and foreign exchange access. The concern with which business views the foreign exchange situation is illustrated by the fact that for the first time since surveys commenced in 2002, law and order, political uncertainty and corruption are not the constraints that are the most significant, although they remain of substantial concern. Infrastructure remains a major impediment, particularly electricity, transport and telecommunications.





44. However, these constraints impact businesses of different sizes unequally. Figure 26 disaggregates the replies between small and large businesses. It shows that Government leases, price controls, problems borrowing and foreign currency issues are the major impediments to small businesses. Notably, these are not the priorities embodied in the government SME policy. Large businesses identify foreign currency issues, work permits and visas and foreign trade issues.

45. Businesses were also asked whether they viewed the environment for investing and doing business was improving; specifically, whether it was better than it was 5 years ago. The respondents indicating that it was worse than 5 years ago outnumbered those replying that it was better by 41% to 14% (Figure 27). The balance of the respondents (45%) indicated that it was about the same, belying statements by senior government officials that the business environment is improving.



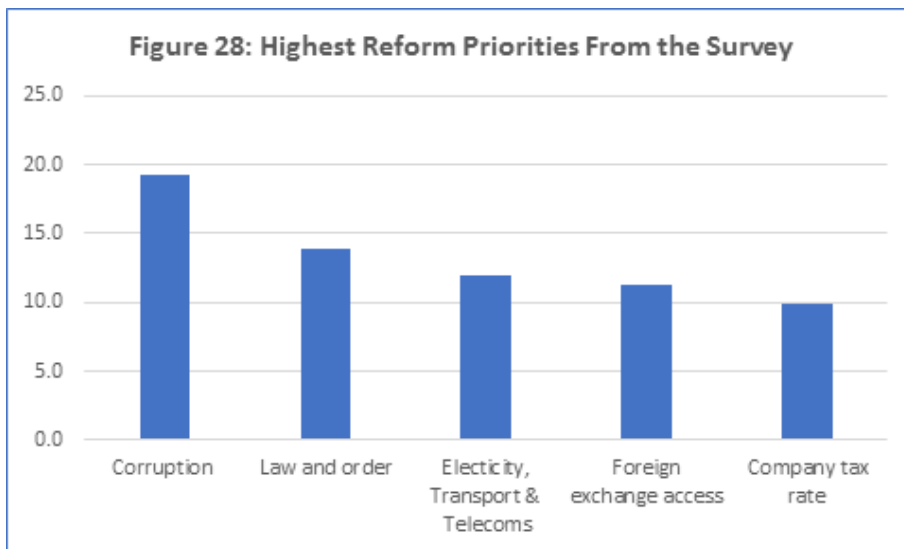
Chapter 6: Key Priorities for Reform

Priorities for Reform from the Survey

46. Business were asked what they viewed as the most important priorities for reform. Figure 28 shows the responses that identified the top 5 reforms that businesses would like to occur. In order of priority, they were: corruption, law and order, infrastructure, foreign exchange access and the company tax rate.

47. With one exception, the issues and the rankings are identical to those identified in the 2012 survey. The exception is access to foreign exchange. Businesses report having great difficulty obtaining foreign currency to pay for imports. An issue that was the 5th reform priority in the 2012 survey, access to land, was not identified as being of such consequence in the 2017 survey.

48. It is surprising that the reform priorities do not follow exactly the issues viewed as constraints to doing business. A possible explanation is that survey respondents only listed as reform priorities factors which they believed were more readily amenable to reform. The law and order and corruption priorities are systemic and could take many years to improve. The company tax rate was the 5th most important priority. PNG's company taxes are high by international standards, with the rate for locally owned companies being 30% and that for foreign companies (outside the resources sector), 48%, which is a substantial disincentive for foreign investors, keeping out of PNG valuable knowledge and investor know how.



Specific Reform Priorities

49. Translating the results of the survey and converting the concerns of the business community into policy reforms will take significant efforts on the part of both government and business. On the one hand, government needs to take the views of the business community into account more closely. On the other hand, businesses should not seek special favours and treatment from government, but rather seek a business environment that rewards investment and entrepreneurship.

50. The business environment is not improving compared with the results of previous surveys. This is taking a toll on the private sector that represents enormous foregone opportunities. The only path to prosperity for PNG is through fostering a vibrant private sector. However, the very low number of exporters in the sample, points to a lack of dynamism. Partly this is understandable because many of the responses in the survey indicate that businesses struggle to deal daily with aspects of the business environment that impose severe costs on their operations. The amount of crime, and the costs of security impose a high tax on business operations, that amounts on average to 10% of the costs of running businesses in PNG. Corruption appears to be endemic (although not universal), and on the rise. At the same time, company tax rates discourage formality and foreign investment that could bring badly needed knowledge and experience in running businesses. Furthermore, the overvalued exchange rate and high input

costs, including from unreliable and uncompetitive provision of public goods and services, makes it difficult for PNG exporters to compete in foreign markets (or for import substitution).

51. The survey revealed that businesses were cancelling or postponing investment because of the uncertainty associated with changes in laws and regulations. This is imposing a substantial cost on the economy in terms of foregone growth.

52. The survey revealed a wide range of business concerns. However, the important priority is to focus on issues that can be dealt with right away. For this reason, there are no suggestions regarding dealing with crime and security, beyond noting that police numbers have fallen far behind population growth and internationally recommended norms. This is a broader societal issue, the costs of which should be constantly on the front page. Research in many countries shows that the most effective way of dealing with crime is to bring the perpetrators to justice rapidly and to sentence them to imprisonment for their crimes. This is obviously an issue that is much broader than promoting private sector development.

53. Here are 4 key priorities derived from responses to the survey.

- The survey showed a significant breakdown in business government relations: There are several forums for consultation between government and the private sector. These need to be used at the highest level, with senior government officials and cabinet ministers attending regularly. Only in this way will trust and understanding between the two be built and policies developed collaboratively. At the same time, the various bodies representing businesses need to do a better job in getting their members involved and in communicating key issues to membership.
- The survey revealed the concerns of business with the low quality of government services, especially Infrastructure and electricity. Studies on SOE productivity in PNG revealed that they are among the lowest in the region. Currently, the focus on managing SOEs is that they be profitable and return revenue to the budget. However, the function of government businesses is not profitability per se, but to use their invested capital to supply products and services as efficiently as possible. In the long run, the productive use of labour and capital determines a country's growth and prosperity. PNG is no exception. The urgent goal of PNG's SOEs should be to achieve higher operating efficiency. The fact that PNG Power Limited has not produced audited accounts

that are publically available indicates a significant lack of transparency and accountability to both taxpayers and users. This should be rectified without delay. A further issue that the survey revealed was the high costs of telecommunications. The undersea fibre-optic cable into the Capital is a government monopoly that contributes to driving up prices and limited capacity. There appears to be some evidence of lack of competition in the cellular phone market. This is an issue that a robust competition policy should address.

- The survey placed concerns and problems regarding PNG's exchange rate and foreign exchange allocation as one of the most significant constraints that businesses currently face. The IMF pointed to the potential costs in terms of lost investment and growth of this imbalance. Attempts to defend an overvalued exchange rate have rarely been successful anywhere in the world. Adjustment, accompanied by appropriate macroeconomic policies should begin without delay. The IMF found evidence that scarce foreign exchange was being directed towards favoured enterprises. This further undermines the perception of impartiality that is needed.
- Corruption was identified as a major and increasing concern. It thrives under circumstances where officials have discretion and where corrupt perpetrators are rarely brought to justice. Furthermore, some members of the private sector promote corrupt practices by making "irregular payments" to gain competitive advantage. Both corrupt officials and those making payments need to be made aware that such behaviour will not be tolerated. The scope for discretion needs to be narrowed through reviews of regulations that are opaque and open to different interpretations. Both officials and the payers of bribes need to be prosecuted and brought to book for corrupt behaviour.

Results of the 2017 Survey of Businesses in Papua New Guinea

