SUMMARY

1. Papua New Guinea's resource-rich economy remains heavily reliant on subsistence agriculture. Its average GDP per capita was just over US$1,000 in 2007. PNG is heavily trade dependent (both on primary exports and manufactured imports, including inputs), and vulnerable to world commodity price movements. Ranking 148th on the UNDP's Human Development Index (a low-ranked medium human development country), PNG has not met the Millennium Development Goals.

2. PNG provides all trading partners at least MFN treatment. It pursues an open trade regime through multilateralism, and preferential regional and bilateral approaches; the relative benefits of these discriminatory agreements may be questionable. An interim EPA with the EU, operative from 2008, triggered preparatory on-going PACER-Plus negotiations with Australia and New Zealand. PNG is concerned that the expected gains from improved access to the EU fish market under the EPA's global fish sourcing rules may be undermined by the EU's adoption of regulations on illegal, unreported, and unregulated (IUU) fishing. PNG is also concerned that Australia and New Zealand will negotiate inadequate access to their semi-skilled and unskilled labour markets.

3. Since 2000, PNG's relatively steady macroeconomic environment has helped sustain growth, but structural reforms have waned recently, particularly since 2006, and fiscal discipline eased. The economy has become more outward looking, with fewer import restrictions, especially lower tariffs, and relatively few formal non-tariff barriers overall. Notable exceptions include the 30-year import ban on petroleum products under the Agreement establishing the Napa Napa oil refinery. In principle, PNG's trade policy has been aimed at the "domestication" of value added across sectors, especially fishing, to promote processing, import substitution, and to diversify the economy.

4. PNG adopted an Export Driven Economic Recovery and Growth strategy in 2002. However, reform of outdated trade-related laws has generally been slow and piecemeal, handicapped by PNG's limited institutional, resource, and technical capacities. Trade policy reforms have essentially paused since the Tariff Reduction Program (TRP), which started in 1999, ended on time in 2006. Subsequent programmes have been deferred, the latest in 2010 until 2011, due to macroeconomic concerns, including the impacts of the global financial crisis and lower mineral tax revenues from falling commodity prices. Support for further reforms has also been eroded by the Government's failure to implement fundamental reforms to reduce binding constraints to PNG's economic and private-sector development (e.g. building infrastructure, improving law and order, and reducing the high costs of doing business), which manufacturers saw as an essential *quid pro quo* for supporting the TRP.

5. A major economic challenge confronting PNG, with wide trade policy implications, is how to manage the "Dutch disease" effects of the kina's appreciation. This is probable from the substantial inward foreign investment in LNG and other projects from the expected mining boom, accentuating the economy's "dualistic" or "two speed" nature. It is likely to reduce the competitiveness of import-competing activities and traditional exports, thus requiring significant structural adjustment in non-mining sectors. The Government believes it is best to avoid tariff increases or other protection, including export assistance. Tariff reductions to lower and more uniform rates would enhance resource-use efficiency, alleviate their anti-export bias, and help offset the kina's appreciation by expanding imports. Despite substantial reforms, tariffs still provide significant (and disparate) effective rates of protection, especially for food processing and other inefficient manufacturing.

6. PNG's robust growth since 2000 peaked at 7.2% in 2007 and remained at 4.5%

in 2009, despite the global recession. Services have grown most, their nominal share of GDP rising from 35.2% in 2003 to 38.1% in 2009. The share of mining (including oil and gas) rose from 18.3% in 2003 to 28.1% in 2008, but slumped to 20.9% in 2009. Agriculture, forestry and fishing fell from 37.2% to 34.5% over the same period, while the share of manufacturing remained at some 6%.

7. While economic growth, earlier reforms, and the massive LNG project hold promise, PNG faces many priorities: improving governance, reducing corruption, and kick-starting reforms, supported by significant improvements to lower the costs of doing business, e.g. promoting efficiency of utilities and building public infrastructure, all of which are sizable impediments to investment and private sector development.

8. PNG's average (unweighted) applied MFN tariff fell from 20.5% in 1999 to 5.1% in 2006, where it has remained. Applied MFN tariffs on agricultural items (WTO definition), averaging 12.5%, generally exceed non-agricultural goods, averaging 3.9% (33.2% and 18.5% before the TRP, respectively). Some three quarters of tariff lines are duty free, with essentially three other bands of 15%, 25%, and 40%, phased down mainly from 25%, 35% and 50%, respectively. The rate of 70% on sugar, which was not lowered to 40% as intended, will remain until 2011. Tariffs are transparent; specific (non-*ad valorem*) duties, which often conceal high rates, apply to only 1% of tariff lines.

9. PNG's fully bound (unweighted) average tariff of 32.8%, which is well above the average applied MFN rate and widened by the unilateral TRP, allows plenty of scope to raise rates within commitments. Thus, while rarely used, this leeway also contributes to the unpredictability of the tariff. A few applied MFN tariffs appear to exceed bound rates.

10. Customs has facilitated trade by modernizing processes and procedures, and improving transparency. ASYCUDA has been upgraded. Brokers can submit declarations electronically, but roll-out has been slow. Some 10% of goods are inspected, and risk management is being developed slowly. Slow clearance reflects mainly delays from inadequate quarantine and port services. PNG, joined the World Customs Organization in 2002, and is acceding to the Revised Kyoto Convention.

11. Customs applies the transaction value. PNG has no anti-dumping, countervailing or safeguards legislation. It has no other discriminatory import duties or charges, no import quotas, and minimal import licensing. PNG controls certain imports predominantly for national health, safety, security, and environmental reasons. Exceptions are the import prohibitions on uncooked poultry and eggs, and licensing restrictions on cooked and processed poultry. Quarantine and SPS restrictions, ostensibly based on risk assessments, appear strictest on fish, but also apply to fruit, vegetables, and meats.

12. The export regime is relatively open. Export taxes, seemingly narrowed in coverage, apply mainly to crocodile hides, and to round logs (28.5% of the f.o.b. value and K 8 per cubic metre), although there is little domestic processing despite the significant implicit subsidy provided via lower log prices. Certain tree exports are prohibited for environmental reasons. Many primary products require export licences, and several statutory marketing boards have exclusive export rights. PNG subsidizes manufactured exports via corporate income tax concessions, the cost-effectiveness of which is questionable.

13. Government procurement, while reformed, is an important instrument of industrial policy. Contracts under K 1 million are reserved for local suppliers, who also receive a preferential margin of 7.5% on larger contracts up to K 10 million. PNG has improved its system of setting standards and conformity assessments, and follows mainly international norms. State-owned enterprises, including statutory monopolies, dominate

many key service industries e.g. power, telecommunications, aviation, water, sewerage, postal services, and ports.

14. The largely unchanged and generally open FDI regime requires foreign investors to be certified and "screened". Joint ventures are voluntary and full foreign equity is allowed (special sectoral rules apply, e.g. in petroleum and minerals, timber, and fisheries). Generous non-transparent selective investment incentives (e.g. tariff concessions) apply on a national treatment basis, subject to significant political discretion and Cabinet approval. Ongoing land tenure reforms should release customary land (accounting for 97% of all land) for economic use. Foreigners may only lease land (up to 99 years).

15. The Independent Consumer and Competition Commission, formed in 2002, enforces competition policy, which includes regulating major state-owned service suppliers, as well as competition law and it administers price controls. The few remaining controls include monitoring of petrol, diesel, kerosene, and aviation fuel prices under the Government's import parity pricing agreement. PNG has significantly improved intellectual property protection, but enforcement is lacking. Customs may *ex officio* suspend clearance of suspected pirated imports for registered right owners (only three existed in 2008). Parallel imports are not banned.

16. The Government views agriculture as a key sector in promoting export-driven growth, rural development, and poverty reduction. Food security, interpreted as self-sufficiency, is a priority. Due to high tariffs, PNG is almost self-sufficient in sugar, pork, and chicken. However, except for oil palm, agriculture has under-performed because of low productivity, largely reflecting inadequate research and development, poor take-up of technological improvements, and lack of scale economies inherent in smallholder farming. Other major constraints include inadequate transport facilities, unreliable and expensive utilities, prevalent crime and lawlessness, and insecurity of land tenure. Major non-oil-palm crops are marketed by statutory boards, including, in the past, operation of price stabilization funds (coffee, cocoa, and coconuts). These may have impeded agricultural development through inefficiency and over-regulation.

17. Logging unsustainability remains a major problem, due largely to permits issued in contravention of the licence moratorium. Fisheries especially are being "domesticated" as licences are tied to on-shore processing; concerns persist over unsustainability in fishing.

18. The Government may take up to 30% minority equity in mining projects. These shareholdings are held by the state-owned Mineral Resources Development Company Ltd (MRDC). In March 2007, the state-owned Petromin Holdings Ltd was formed to hold the State's assets and to maximize indigenous ownership and revenue gains in mineral and petroleum projects. A share of the State's equity in the LNG project will be held by the new state-owned Kroton No. 2 Ltd.

19. Telecommunications reform, after delays and uncertainty, is moving towards competition and ending the state-owned Telikom monopoly over fixed-line services (local, national, and international calls), due from August 2010. The mobile monopoly ceased in 2007 when Digicel entered the market, with its share rising to 65% in 2009, and prices falling by up to 60% along with improved coverage and quality. Regulation of telecoms is being transferred from the ICCC to a new independent regulator, the National Information Communications Technology Authority (NICTA), which will replace the PNG Radio Communications and Telecommunications Authority (PANGTEL).

20. The state-owned, inefficient, monopoly power utility, PPL, is regulated by the ICCC, but still supplies unreliable and expensive electricity, thus raising business costs. While PPL was corporatized for privatization, this did not go ahead. It has been under financial pressure, compounded by

difficulties in servicing government loans and overseas borrowings. The forthcoming National Electricity Policy is considering focusing on reforms to private-sector participation and competition, especially in generation.

21. The financial sector, which weathered the GFC reasonably well, is relatively open and privately based, except for the state monopoly in the provision of compulsory third-party motor-vehicle insurance and general reinsurance. Government policy is to maintain an "open" regime for financial institutions meeting the licensing criteria. The Bank of PNG (Central Bank) prudentially regulates the financial sector, and claims its prudential and supervisory functions have been strengthened to comply with international best practice.

22. Competition on air routes to Australia has increased recently, with Pacific Blue entering as a code-share partner for Airlines PNG to compete with Qantas, which code-shares with Air Niugini. Foreign equity controls apply to air services. Cabotage is prohibited, including in coastal shipping; removal would reduce domestic shipping and business costs substantially. Improvements in airline access, infrastructure, utilities, and telecommunications are necessary pre-requisites for expanding tourism.

23. While PNG's economic outlook will depend on world commodity prices and other developments, more important will be whether it can successfully meet its domestic economic policy and related challenges. WTO Members can help by ensuring open markets for its exports. Greater technical assistance and international aid are required, but must be provided in a more targeted and efficient manner to help PNG achieve its priority reforms, and not to compound its economic problems (e.g., accentuating the "Dutch disease" effects).