



The Challenges of Doing Business in Papua New Guinea

An Analytical Summary of the
2012 Business Environment Survey
by the Institute of National Affairs



business challenges





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Acronyms

ADB	Asian Development Bank
CIMC	Consultative Implementation and Monitoring Council
K	Papua New Guinean kina
LNG	liquid natural gas
OLIPPAC	Organic Law on the Integrity of Political Parties and Candidates
PNG	Papua New Guinea
PPP	public–private partnership
PSDI	Private Sector Development Initiative



Overview

Introduction

This report summarizes key results from a business survey in Papua New Guinea (PNG) in 2012.¹ It provides insights and suggestions for policy makers, and acts as a resource for anyone interested in PNG's development.

Comparative analysis using data from similar surveys in 2002 and 2007 offers insights into changes in the business environment since 2002. These comparisons highlight the impact of the 2011 constitutional crisis, and the acceleration of economic growth since 2007.

The business environment has improved since 2002, but doing business in PNG remains extremely challenging. Efforts to improve the business environment will help create a foundation for sustained, inclusive, and diversified economic growth, which builds on that generated by the resource boom.

Structure and Composition of the 2012 Survey

The May–December 2012 survey concerns 130 firms that responded to 70 questions on the following themes:

- impact of political uncertainty;
- effect of government regulations and policies;
- cost of crime and security;
- government–business relationships;
- effectiveness of government services; and
- constraints to business and investment.

Nearly two-thirds of participating businesses were PNG-owned, while one-third were foreign-owned, and a few were jointly owned. The majority of businesses were formally registered, and 89% had been in business for more than 5 years. More than 40% operated outside the main commercial centers of Port Moresby and Lae, and approximately 20% exported products or services.

¹ Institute of National Affairs. 2013. *The Business and Investment Environment in Papua New Guinea in 2012: Private Sector Perspective—A Private Sector Survey*. Port Moresby.



The sample included businesses of all sizes. Approximately half had an annual turnover of less than K5 million, and could be classified as small and medium enterprises. The remainder was larger businesses, including multinationals.

Surveyed businesses were drawn from 10 industry groups:

- agriculture;
- forestry and fisheries;
- building and construction;
- finance and investment;
- hotel, restaurants, and bars;
- manufacturing;
- mining and petroleum;
- retail and wholesale;
- transport and communications; and
- other services (e.g., utilities, gaming, personal services, etc.).

Comparisons with the 2002 and 2007 surveys' data have been included to track changes in the business environment. Although the sample composition and volume varied slightly, the design and methodology was consistent and the composition group sufficiently representative to ensure comparability across the three surveys.

Constraints Identified in Previous Surveys

The 2002 and 2007 PNG surveys and the Asian Development Bank's (ADB) private sector assessments identified the following main constraints to doing business:

- political uncertainty;
- law and order problems;
- instability of laws, rules, and regulations;
- poor relationships with Government;
- corruption; and
- poor quality and availability of infrastructure.

The previous analyses also identified exchange rate variability, inflation, skilled labor shortages, and local government inefficiencies as additional constraints to doing business. Despite some improvement in the business environment between 2002 and 2007, these problems continued to affect most businesses.



Summary of Key Findings

While the business environment improved in the decade following 2002, doing business in PNG remained extremely challenging in 2012. The most important issues identified in the 2012 survey were:

- **Business security:** law and order was the most pressing issue for businesses and their highest reform priority. Confidence in law enforcement agencies and the judiciary was low. Most businesses had been victims of crime and employed private security guards and other measures to protect themselves. Crime, and the measures to prevent it, contributes significantly to business costs.
- **Government–business relationships:** most businesses found the government unhelpful. Irregular payments to government officials appear to have become more common, and corruption was rated as the second highest reform priority.
- **Infrastructure and services:** The poor quality of infrastructure for transportation and electricity was a critical concern in 2012. While telecommunications had improved since Digicel's entry in 2007, access and affordability were still problems.
- **Government regulations and policies:** Burdensome and complex regulations continued to discourage investment. Most businesses suffered under sudden changes in regulations and policies.
- **Political uncertainty:** Businesses were still highly impacted by political uncertainty, despite fewer changes in government.
- **Supporting institutions:** Businesses had reasonable confidence in key institutions like the Company Registrar and the Securities Commission. They were more confident in private bodies regulating professions such as law and engineering, and were highly confident in the financial sector.
- **Constraints to business and investment:** Law and order, corruption, and poor infrastructure constrained business and investment the most.

Key Policy Recommendations

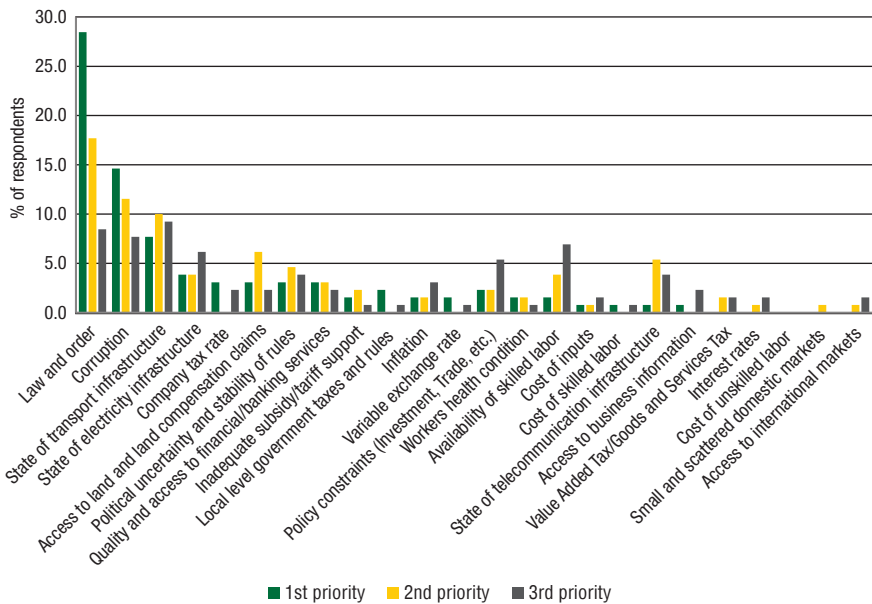
The most important policy recommendations arising from the 2012 survey are:

- Ensure adequate resources to improve key agencies' capacities in the law and justice sector, including the police, correctional services, and judiciary.
- Increase efforts to tackle corruption through reforms to public procurement and land administration, and reinforce existing controls and safeguards.



- Strengthen existing mechanisms for public–private dialogue, and consult with the private sector to ensure that policies and legal changes impacting business are developed.
- Implement a legal framework to promote greater use of public–private partnerships to deliver infrastructure and services.
- Restructure state-owned enterprises to allow greater private sector participation and competition in the electricity, transport, and telecommunications sectors.
- Simplify and streamline licensing, business regulations, and taxation to reduce compliance costs and approval times.
- Review the land-leasing framework to make more land available for business investment and expansion.

Figure 1: Top reform priorities



Source: Institute of National Affairs.



Background

In PNG, macroeconomic stability, growth, and the passage of the Organic Law on the Integrity of Political Parties and Candidates (OLIPPAC) in 2001 have all contributed to greater political stability. A coalition led by Sir Michael Somare and the National Alliance Party was formed following the 2002 election, and was the first government since independence to complete a full 5-year term. The National Alliance appeared to benefit from the introduction of limited preferential voting in the 2007 election, and Sir Michael formed a successor government that looked likely to complete a second full term. However, Sir Michael's illness and absence from Parliament in 2011 led to the formation of a new government under controversial circumstances, with Peter O'Neill as Prime Minister.

The ensuing constitutional crisis led to political uncertainty that continued until the June 2012 national elections. However, this uncertainty had little short-term impact on the economy, as commodity prices remained high and development of the \$19 billion PNG liquid natural gas (LNG) gas project was uninterrupted.

The O'Neill–Dion government has committed to growing the private sector and fighting corruption. It has increased public expenditure on infrastructure, law and order, land reform, and education. While the government's resource allocations and policy priorities align with businesses' priorities, recent changes to business policy could exacerbate some of the issues the 2012 survey identified.

Key changes in 2013 included a change in the shareholding of the Ok Tedi Mine, a major amendment to the Takeover Code, and a government decision to establish a foreign investment review board. The government also committed to restricting foreign investment by reserving certain businesses for Papua New Guineans. These changes are likely to discourage foreign investment and may ultimately reduce the rate of growth and job creation.

The amendment to the takeover code is an example of the kind of sudden and unexpected policy change that businesses are concerned about. The amendment added a discretionary 'national interest' test to the review process for proposed takeovers. It appears to have been designed to block a major Malaysian producer from acquiring PNG's largest palm oil producer, but will now apply to all businesses that are subject to the code.



Many new and existing businesses could be affected, but the government did not formally consult with the private sector or communicate the amendments' intent and implications. Changes like these create a worrying precedent and, in the absence of consultation on policy and implementation, it is natural for businesses and investors to become more cautious.



Analysis of the Business Environment— 2012, 2007, and 2002

Political Uncertainty

When the normal risks of doing business are compounded by political risks, investors demand higher returns and shorter payback periods. Many productive investments that would be made in a more stable environment are not made. This can reduce growth and discourage innovation. Further, experience suggests that investors have long memories and tend to respond cautiously to improved political environments.

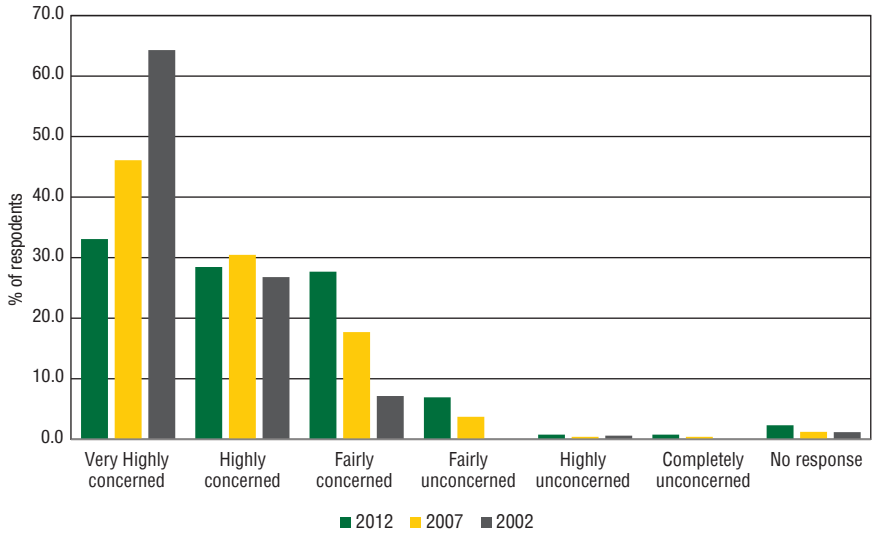
Most businesses surveyed in 2012 were concerned about political stability (Figure 2), with two-thirds either 'highly concerned' or 'very highly concerned'. However, comparison with 2002 and 2007 responses shows that the proportion of businesses that were 'very highly concerned' fell significantly. This could be attributed to the trend towards more stable ruling coalitions, although frequent changes in the key ministerial positions in a coalition can also be perceived as a source of political instability.

Political uncertainty directly impacts business (Figure 3). In 2012, nearly 70% of the businesses reported that they were affected by political uncertainty. However, comparison with previous surveys shows a clear reduction in businesses that were 'highly' or 'very highly' affected. This can be attributed to the stability of the political environment between 2002 and 2011, and the relatively small impact of the subsequent constitutional crisis on the economy.

The collective responses show that political stability remains a major concern for businesses in PNG. This shows that attitudes towards risk are not symmetrical, and that it is often easier to destroy rather than restore confidence.

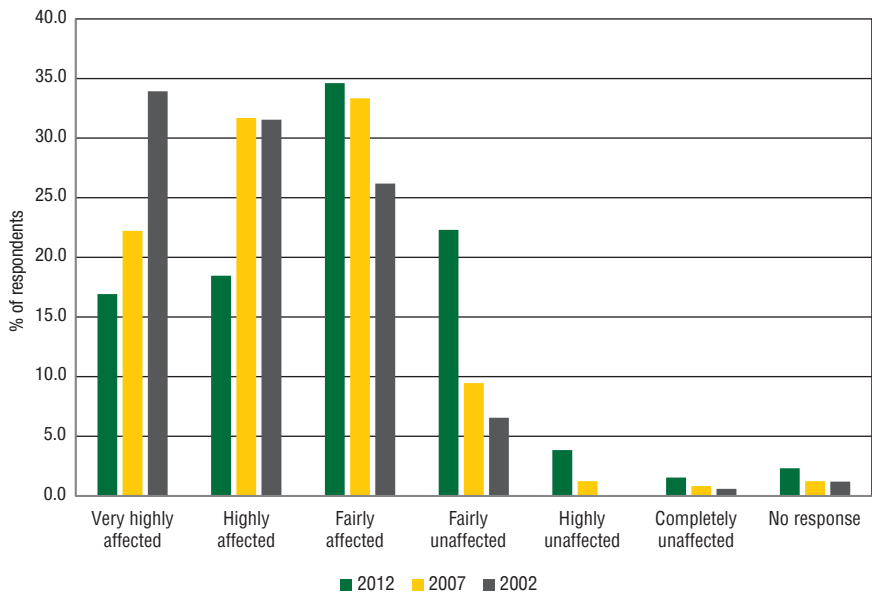


Figure 2: Levels of concern about political stability



Source: Institute of National Affairs.

Figure 3: Impact of political uncertainty on business



Source: Institute of National Affairs.



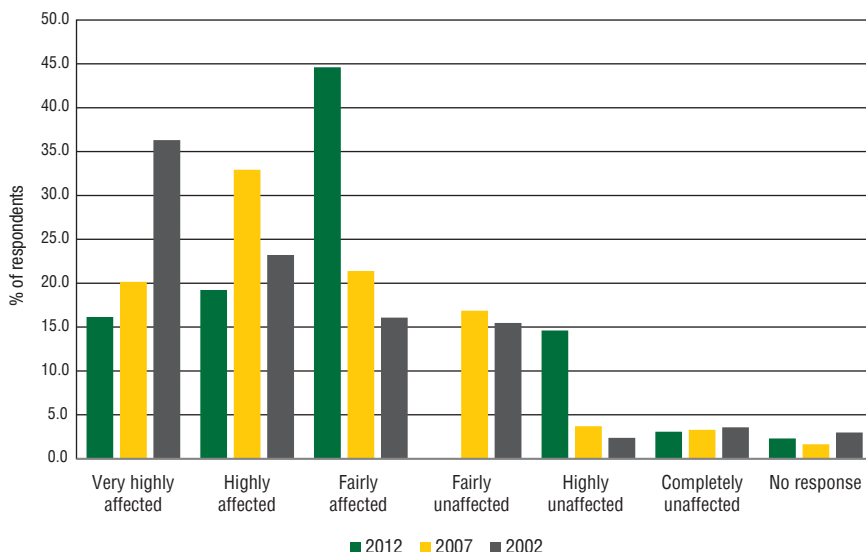
Business Security, Crime, and the Courts

In 2012, law and order was again ranked as the most pressing concern for business and the top priority for government action. If the legal code and law enforcement institutions cannot ensure public safety, it becomes harder to do business and investment becomes more risky. Security is a key public good that the State needs to supply. Businesses can act to protect themselves from crime, but this can never fully replace the State providing a legal code, policing, and enforcement.

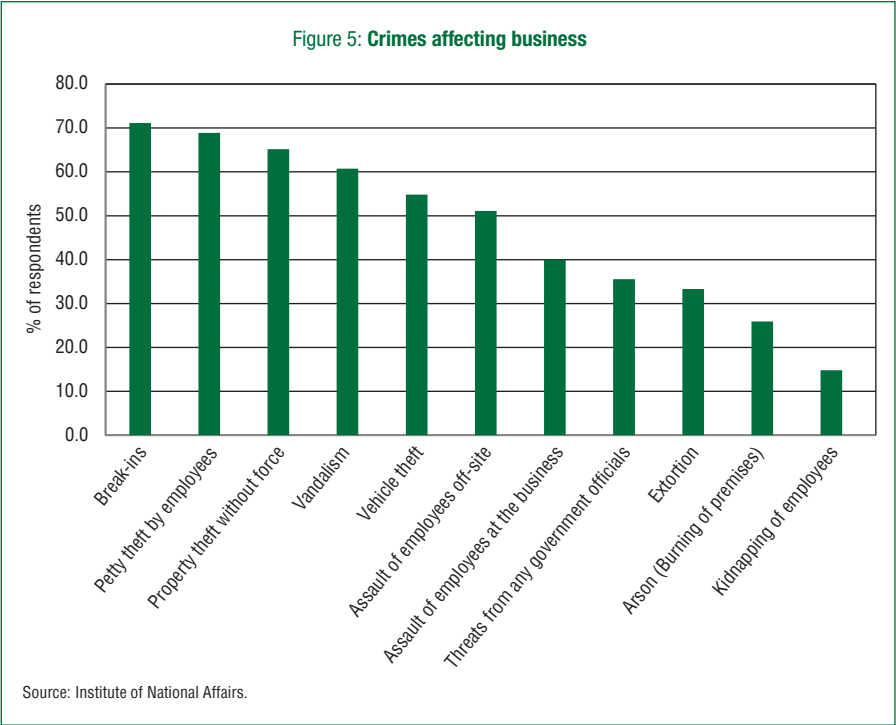
Approximately 80% of respondents reported that law and order problems have influenced their business and investment decisions (Figure 4). The reduction in the proportion of businesses that were ‘highly’ or ‘very highly’ affected by crime is encouraging, although the total proportion affected rose in 2012. The reduction in the ‘highly’ and ‘very highly’ categories may also be associated with more favorable investment conditions created by PNG’s recent high growth and, possibly, improvements in businesses’ risk management.

Businesses surveyed in 2012 listed a wide range of crimes affecting their operations (Figure 5). The impact of the unsafe environment extends far beyond the direct cost of these crimes. Expenses increase when businesses

Figure 4: **Impact of law and order problems on business and investment**



Source: Institute of National Affairs.



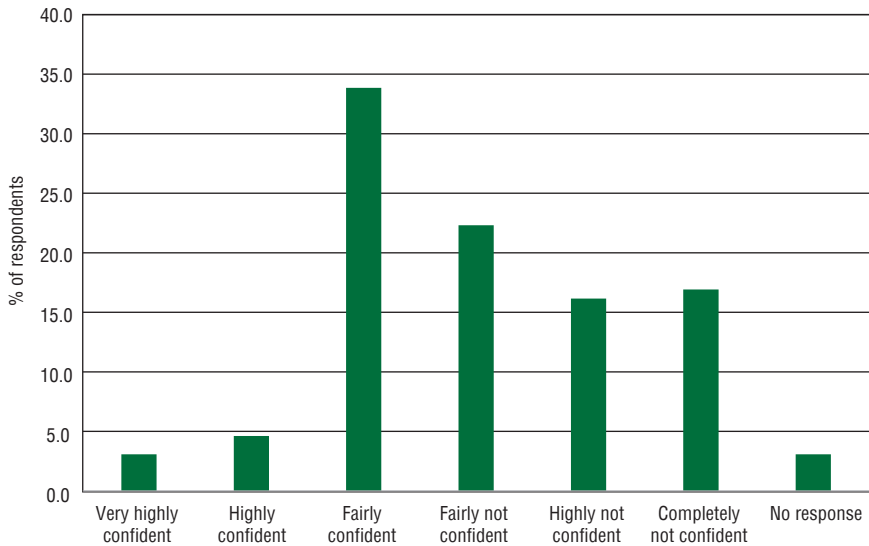
have to protect their staff and property, insurance is more costly, and it becomes harder to recruit specialist international staff. Security problems can also impact productivity, as businesses adjust working patterns and reduce operating hours to lower their risks.

Confidence in law enforcement bodies is low (Figure 6). Fewer than 10% of the companies surveyed in 2012 were either ‘highly’ or ‘very confident’ in law enforcement, and the majority of businesses indicated a lack of confidence. Similarly, confidence in the judicial system was low. In 2012, only 50% expressed a conviction that the judicial system would prosecute law breakers and enforce contracts fairly (Figure 7).

There was a dramatic decline in confidence in law enforcement bodies and the judicial system. In 2002, 44% of businesses were either ‘highly’ or ‘very highly’ confident in the judicial system; this dropped to 18% in 2007, and fell to 14% in 2012. This decline is serious, given the judicial system’s crucial role in the criminal justice system and in enforcing contracts. This is another area of public goods provision that the business community in PNG views as inadequate.

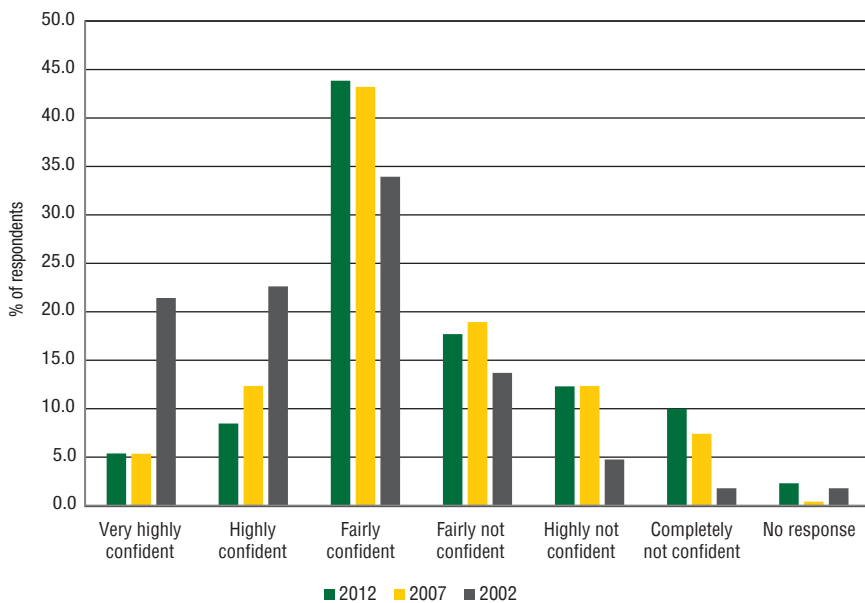


Figure 6: Business confidence in law enforcing bodies



Source: Institute of National Affairs.

Figure 7: Confidence in the judicial system and courts



Source: Institute of National Affairs.

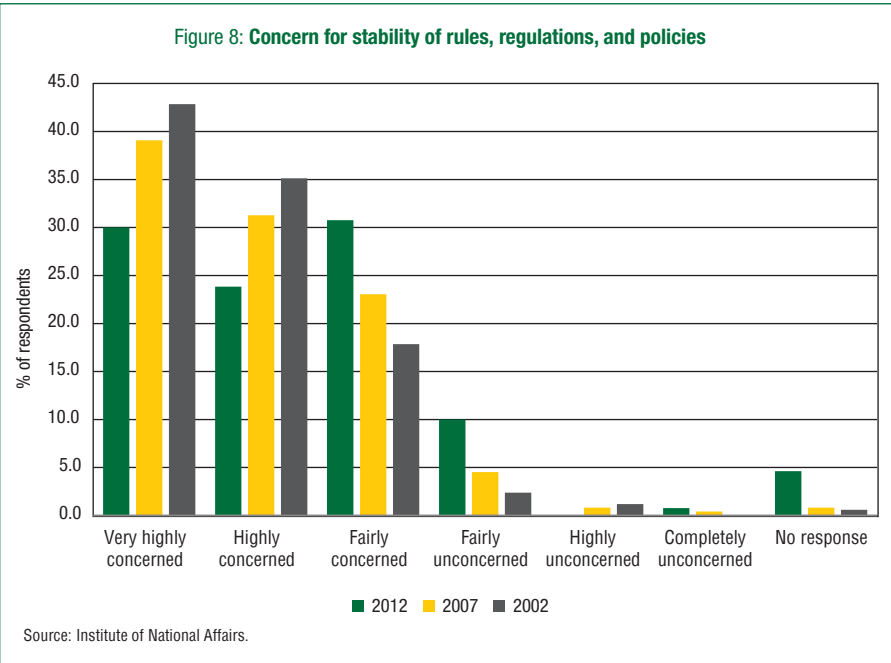


Government Regulations and Policies

The quality of economic, legal, and social institutions is a key determinant of long run growth.² The government supports these institutions’ mandates by shaping formal policy, rules, and regulations. These ‘rules’ determine the ease of operating a business in the formal sector. Complicated, burdensome rules increase compliance costs, encourage informality, and block new investment.

Investment is encouraged by a stable set of supportive rules, regulations, and policies. Unfortunately, the businesses surveyed were concerned about the stability of these factors (Figure 8) and, in 2012, over half identified stability as either a ‘very high’, or ‘high’ concern. If the ‘fairly concerned’ group is included, then over 85% were concerned about the stability of rules, regulations, and policies. Despite improvement since 2002 and 2007, this rate remained alarmingly high in 2012.

This is important, because sudden changes in rules and regulations impose adjustment costs on business and can even result in profitable businesses closing down. When considering new investments, businesses



² Rodrick, Dani. 2000. *Institutions for High Quality Growth: What They are and How to Acquire Them*, National Bureau of Economic Research Working Paper 7540. February.

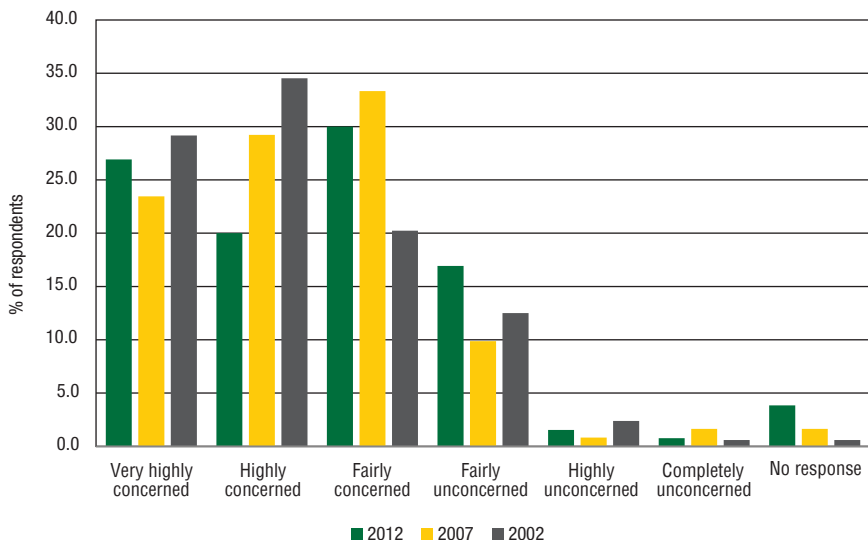


and entrepreneurs analyze the expected investment return. When rules and regulations are unstable, the possibility of unexpected changes increases the risks. This discourages investment and business formation.

Changes to policies, rules, and regulations can be applied on a forward or backward basis. Retrospective changes can be particularly damaging, since investors are often unable to anticipate them when first investing to develop the business. As a result, retrospective changes can seriously undermine business and investor confidence and reduce total investment.³

The proportion of respondents concerned about retrospective changes has increased since 2007, and was over 80% in 2012 (Figure 9). This is worryingly high. Two-thirds of businesses indicated that when changes in government occurred, they expected major policy changes that damage their business. At the same time, very few businesses expressed confidence in the full implementation of new policy announcements, with only 11% ‘always’ or ‘mostly’ confident (Figure 10). Despite some improvement between 2002 and 2012, concerns about the continuity of policy and the implementation of new initiatives remain high.

Figure 9: Concern for retrospective changes to rules and regulations

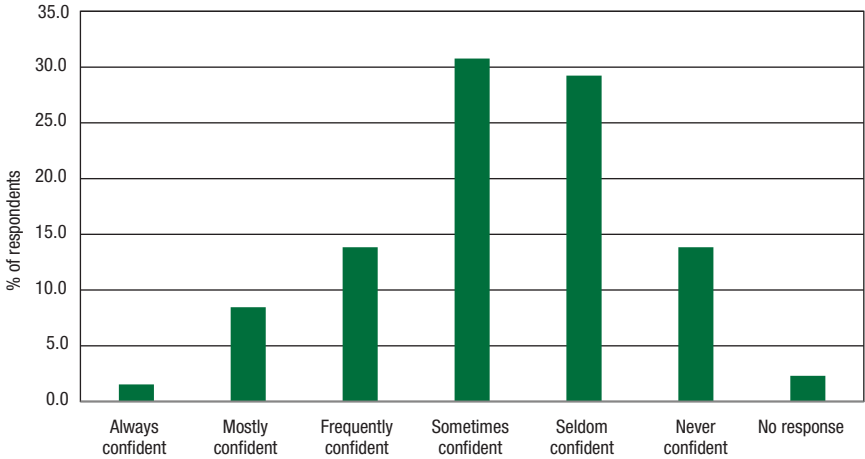


Source: Institute of National Affairs.

³ Examples include the introduction and repeal of amendments to the Environment Act 2000 (the Environment (Amendment) Act 2010), and ongoing discussion about proposed amendments to the Mining Act 1992, which would change how mining companies operate by shifting mineral ownership from the State to local landowners.



Figure 10: Business confidence in full implementation of policy announcements



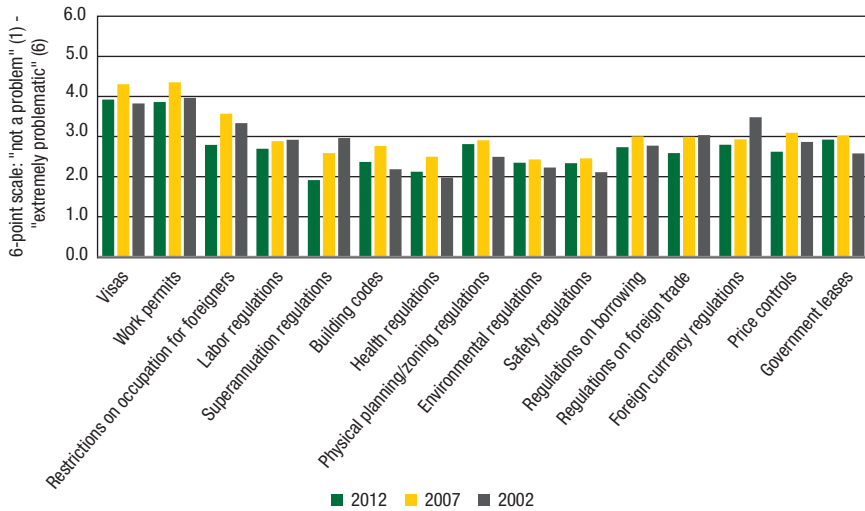
Source: Institute of National Affairs.

A more detailed question on the impact of government regulations suggests that the process for arranging work permits and visas for foreign workers continued as problematic in 2012. More encouragingly, Figure 11 reveals fewer problems caused by restrictions on foreigners’ occupations, superannuation regulations, and foreign currency regulations. Improvements in superannuation regulations and foreign currency controls can be traced to legislative reforms in 2000, and demonstrate the potential benefits of concerted reform.

Notwithstanding small improvements since 2007, difficulty in complying with government regulations continues to deter investment. In 2012, 30% of total businesses reported that they had cancelled planned investments due to compliance problems. The complexity of rules and regulations and the time needed for administrative processes were two of the most commonly cited problems. Complex regulations highly burden businesses with annual turnover below K5 million, million, with 38% (18% ‘excessive compliance fees,’ and 20% ‘too complex and haphazard’) reporting that they had cancelled investment plans because of compliance-related problems (Figure 12).

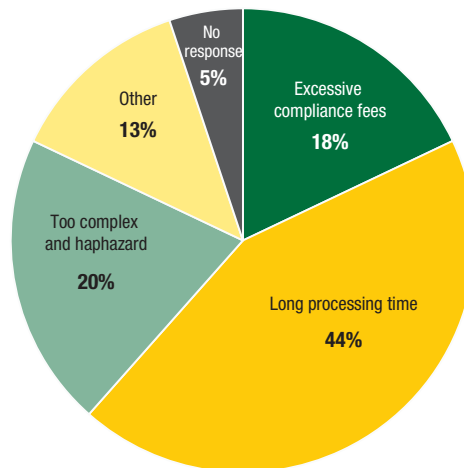


Figure 11: Impact rating of government controls on a 6-point scale



Source: Institute of National Affairs.

Figure 12: Reasons for deciding not to proceed with a major investment



Source: Institute of National Affairs.

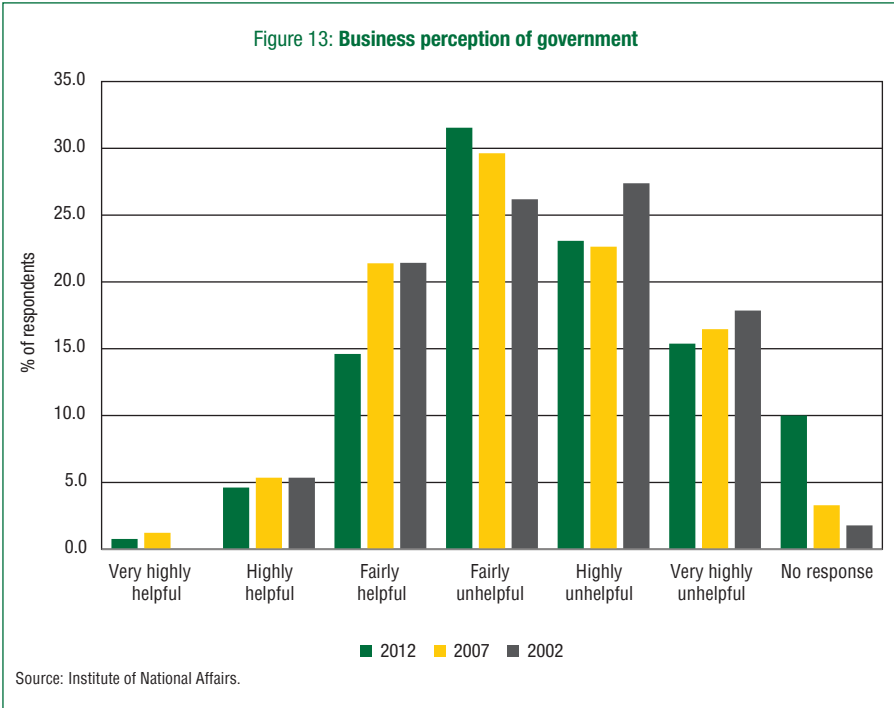


Government–Business Relationships

Collaborative relationships between government and the private sector are an important feature of a well-functioning business environment. Dialogue and consultation build trust, and ensure that businesses have an input into new policies that will affect their operations. Other features of good relationships include businesses’ willingness to engage with government, comply with laws and regulations, and refrain from seeking special treatment.

Since 2007, progress with improving government–business relationships has been mixed. The National Working Group on Removing Impediments to Business and Investment was established as a high-level forum for public–private dialogue, but ceased operation in 2009. It was reinstated in late 2011, and now meets regularly. The Consultative Implementation and Monitoring Council (CIMC) provides another forum for structured public–private dialogue. Private sector representative bodies also engage with the government through other channels.

However, efforts to improve public–private dialogue did not translate into improved government–business relations in 2012 (Figure 13). Approximately





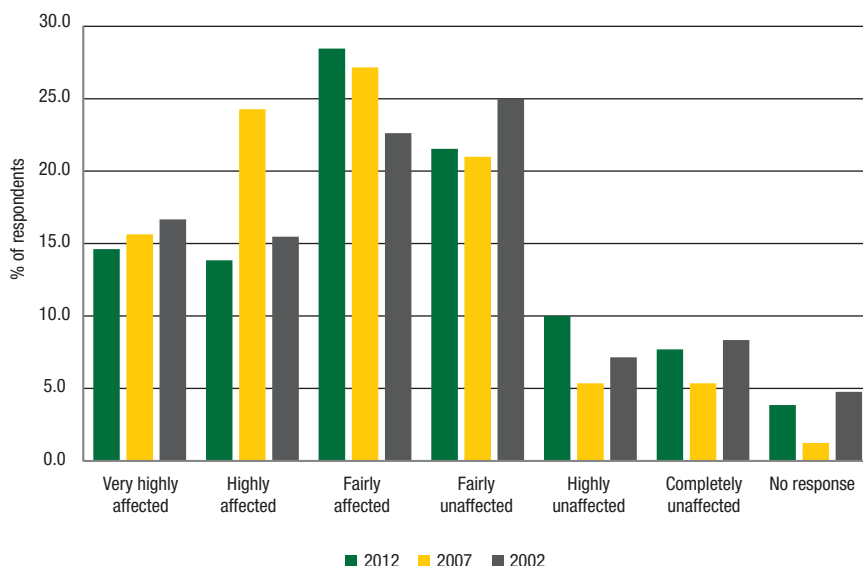
40% of respondents in 2012 described bureaucratic and government relationships as ‘highly unhelpful’ or ‘very highly unhelpful’. Very similar results were found in 2002 and 2007, suggesting little or no improvement.

Questions about consultation during policy development offer further insight into weak government–business relationships. While 83% of surveyed businesses believed that they should ‘frequently’, ‘mostly’, or ‘always’ be consulted during the development of new policies or regulations, more than half were unaware of public–private consultations.

Efforts to strengthen the government–business relationship can also be undermined by corruption. A predatory attitude towards business by politicians or bureaucrats fosters cynicism in the private sector and, in the long run, reduces investment.

Corruption is a serious issue for businesses in PNG with 57% of respondents in 2012 reporting that they had been ‘fairly’, ‘highly’, or ‘very highly’ affected by instances of government corruption (Figure 14).

Figure 14: Impact of government corruption on business



Source: Institute of National Affairs.



The proportion reporting that it was ‘mostly’ or ‘always’ common for companies in their sector to make ‘irregular additional payments’ to government officials increased from 17% in 2002 to 30% in 2012. This suggests that low-level corruption became more common (Figure 15).

However, the benefit of making ‘irregular payments’ is limited; only 30% of businesses reported actual service delivery without further demands for payments. Businesses also have little recourse when government officials demand irregular payments. In 2012, 22% reported never seeking recourse, and only 14% reported that they could ‘mostly’ or ‘always’ seek recourse.

Government land administration appeared to be a focal point for corruption, with 44% of businesses reporting a negative impact on their business and investment plans. Businesses also identified finance, tax, customs, and government procurement as problem areas (Figure 16).

Figure 15: Perceived prevalence of irregular payments to officials

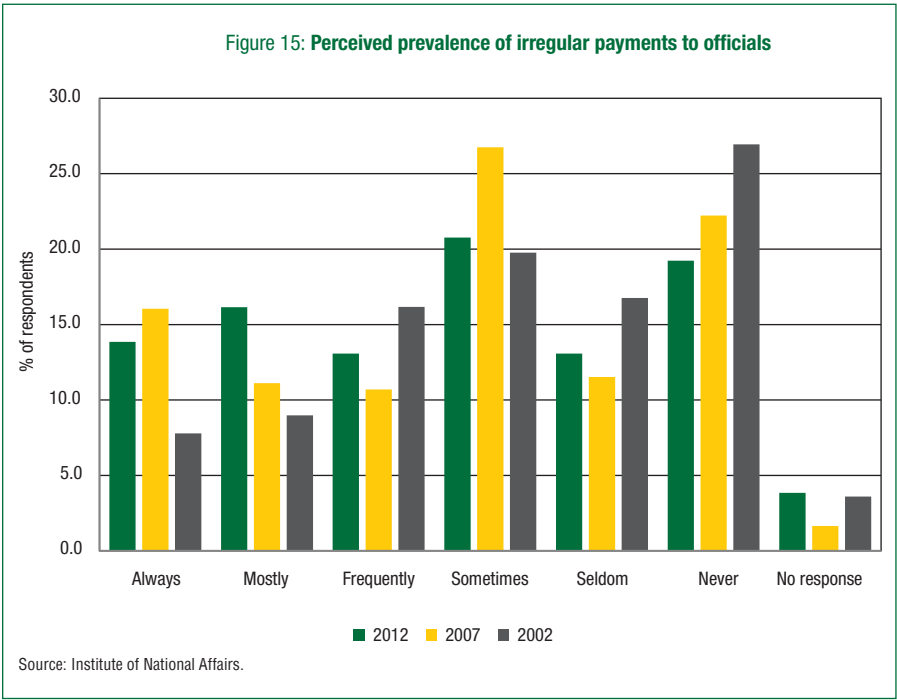
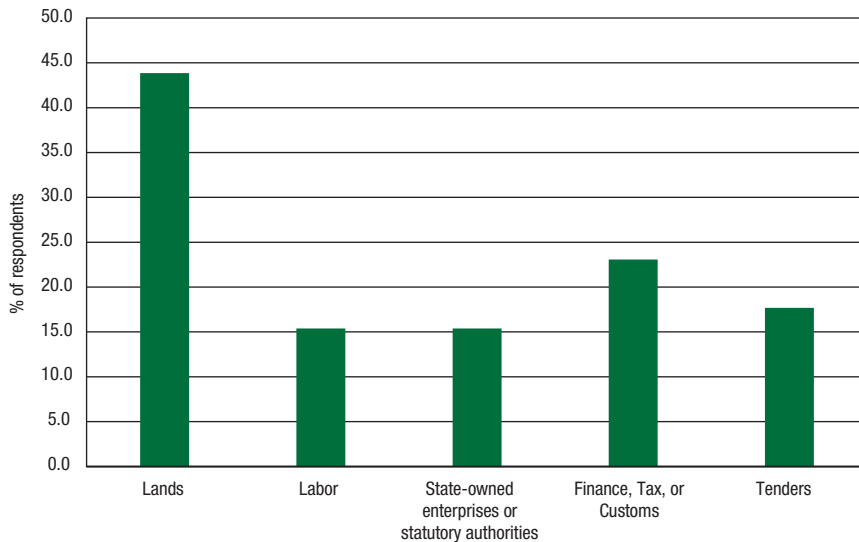




Figure 16: Areas of government in which businesses experience corruption



Source: Institute of National Affairs.

Infrastructure and Public Services

Most businesses rely on physical infrastructure and supporting services the government provides. A favorable business environment needs good quality infrastructure and efficient public services. Conversely, poor quality infrastructure and services can increase business costs and discourage investment.

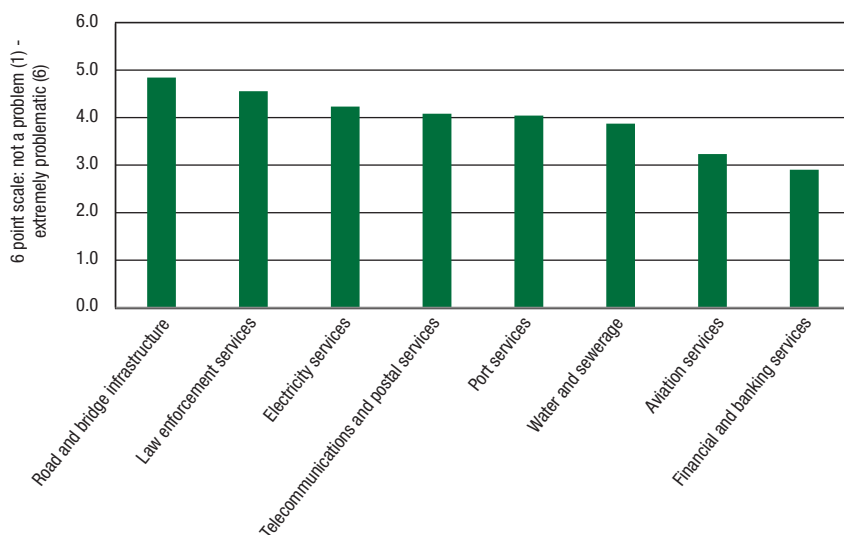
PNG's physical infrastructure is underdeveloped. The poor condition of roads and bridges remained the most pressing government service concern for business in 2012, with no improvement in the perceived quality since the 2007 survey (Figure 17). Businesses rated electricity services, ports, and water and sewerage services as poor quality and inefficient, and concerns about port services had increased since 2007. All these services providers are government owned, and reinforce findings of the low efficiency of state-owned enterprises in Papua New Guinea.⁴

Surprisingly, telecommunications services also rated poorly, despite significant improvements in mobile network coverage since 2007. This may

⁴ ADB. 2012. *Finding Balance: Benchmarking the Performance of State-Owned Enterprises in Papua New Guinea*. Sydney.



Figure 17: Business rating of specific government services



Source: Institute of National Affairs.

be explained by the high cost of accessing the internet in 2012 and by the poor performance of the state-owned telecommunications providers. Tellingly, government retains a monopoly on access to the internet undersea cable, which previous analysis identified as being a major barrier to reducing costs and increasing access to electronic services.⁵

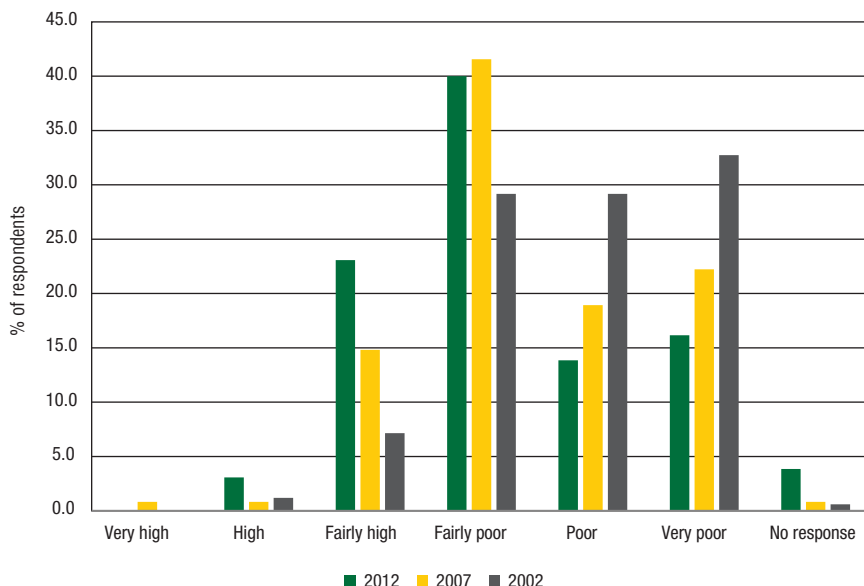
The areas of least concern to business all feature substantial private sector provision—namely, aviation and banking services. This suggests that greater private sector participation in the electricity and ports sectors would help to improve the business environment. Public–private partnerships (PPPs), privatization, and deregulation are mechanisms to achieve this.

Businesses' perceptions of the quality, efficiency, and effectiveness of a wider range of government services did seem to improve in 2012 (Figure 18), despite ongoing challenges in government-provided infrastructure. While only 3% rated government services as 'very highly' or 'highly' efficient, the proportion that rated government services as 'very poor' or 'poor' fell from 62% (2002) to 30% (2012). However, 65% of businesses stated that they 'agree' or 'strongly agree' that major reforms will lead to improved government services quality.

⁵ ADB. 2008. *Foundation for the Future: A Private Sector Assessment for Papua New Guinea*. Sydney.



Figure 18: Business rating of government services



Source: Institute of National Affairs.

Supporting Institutions

A range of institutions support businesses by facilitating commercial activity and maintaining professional standards. Where these services are provided efficiently and without undue political interference, they play an important role in facilitating business.

The Registrar of Companies and the Securities Commissioner are key offices for administering business law in PNG, and most businesses expressed some confidence in them. However, only 22% of respondents were either 'highly' or 'very highly' confident.

Businesses expressed slightly greater confidence in the non-governmental bodies that regulate professions like law and engineering. This is probably linked to their relative autonomy. Reassuringly, businesses have high levels of confidence in the financial sector, with 92% of businesses 'fairly', 'highly', or 'very highly' confident in PNG's banks and financial institutions.

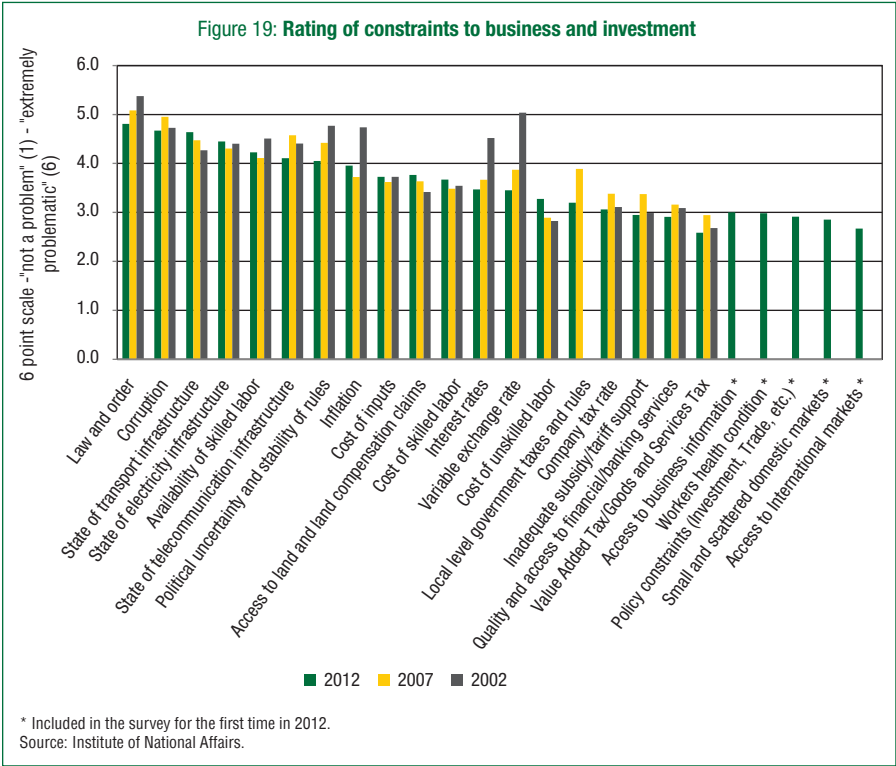


Constraints to Business and Investment

Businesses rated the impact of 24 potential constraints to business and investment using a 6-point scale, ranging from ‘not a problem’ to ‘extremely problematic’ (Figure 19). The ratings confirmed many of the key issues identified in other parts of the survey. Comparison with the ratings of the same constraints in 2007 and 2002 also offers insights into the evolution of the business environment between 2002 and 2012.

Law and order problems again rated as the most serious barrier to business and investment, although the situation does seem to have improved. Corruption, poor transport, and electricity infrastructure, and skills shortages also ranked highly. Unfortunately, the data suggests that the impact of these constraints remained stable or worsened.

Poor telecommunications infrastructure was also rated as an important business constraint. Liberalization of mobile telecommunications in 2007 and the subsequent entry of Digicel led to large increases in network coverage,





service quality, and subscriber numbers, as Digicel invested significantly in capacity. Improvements since 2007 reflect this progress. As the need for internet connectivity has increased, so has the negative impact of high cost and poor quality services. This appears to have reduced some of the expected benefits of greater mobile connectivity.

The benefits of the macroeconomic stability that has followed the structural reforms of the early 2000s are reflected in the reduced impact of inflation, interest rates, and exchange rate variability on businesses. This stability was supported by strong growth but would not have been possible without the fiscal discipline associated with the move to medium-term fiscal planning. Government policy in this area appears to have been effective.

The impact of political uncertainty fell between 2007 and 2012. This implies that 2011's constitutional crisis did not undermine the broader benefits of a more stable political environment.

Difficulty in accessing land and high compensation costs became a more pressing constraint for business between 2002 and 2012. The proportion of businesses reporting that difficulty in accessing land had significantly hindered their expansion rose from 38% in 2002 to 58% in 2012. The rapid increase in land prices in many parts of PNG may help to explain these responses, yet these increases are partly caused by supply shortages stemming from land administration bottlenecks. Land administration issues and leasing policy constraints mean that a review of the land-leasing framework is urgently needed to make land more readily accessible for business.

Despite PNG's recent high growth rates, unemployment and underemployment are serious issues. While concerns about the cost and availability of skilled labor rose between 2007 and 2012, businesses were also increasingly concerned about unskilled labor costs. This was not the only problem for employers and, in 2012, 77% of businesses reported problems with low productivity and absenteeism caused by illness and poor health.





Going Forward

The survey results have a number of public policy implications. In 2012, the private sector still found the government unhelpful and feared political uncertainty and unexpected changes in policies and regulations. Other pressing concerns all related to the government's poor capacity to deliver essential public goods, and to efficiently administer its rules and regulations.

PNG's rapid economic growth between 2007 and 2012 was driven by high commodity prices, new resource developments, and expanded telecommunications and finances.⁶ The strong growth was accompanied by small but significant improvements in the business environment that created a strong foundation for further improvement.

In the long run, PNG's prosperity will depend on its ability to develop a dynamic and competitive private sector. This will require a progressive transformation of the business environment to address the many barriers to doing business identified in the 2012 survey. In many areas, radical reform is necessary to promote the continued growth on which PNG's future prosperity depends.

⁶ International Monetary Fund. 2013. *Papua New Guinea: Staff Report for the 2013 Article IV Consultation*. Washington, DC.



The Challenges of Doing Business in Papua New Guinea

An Analytical Summary of the 2012 Business Environment Survey by the Institute of National Affairs

This report summarizes key results from a 2012 survey of businesses in Papua New Guinea. It compares the results with the 2002 and 2007 surveys and shows that, while the business environment has improved since 2002, doing business in Papua New Guinea remains extremely challenging. Continued concerted efforts to improve the business environment will help sustain economic growth to build on opportunities the resource boom generated.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than \$2 a day, with 903 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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