

III. TRADE POLICIES AND PRACTICES BY MEASURE

(1) INTRODUCTION

1. Trade taxes are PNG's main intervention measures and an important source of government revenue, accounting for well over one quarter of total taxes in 1998. However, a major tax and tariff reform programme, implemented from 1 July 1999, has reduced reliance on tariffs by significantly cutting duty rates across-the-board and implementing a broad-based 10% VAT on goods and services. Tariffs were reduced immediately to 9%, from a simple applied MFN average rate of 20%, and will be phased down to 5% in 2006. Tariffs currently range from zero to 55%, subject to a few exceptions such as sugar and canned mackerel. Maximum tariffs on all products will fall to 40% in 2006. Export taxes are levied mainly on unprocessed logs at progressive rates of up to 70%.

2. While tariffs are almost exclusively *ad valorem*, the transparency of the tariff system has in the past been greatly undermined by the widespread use of discretionary exemptions. These were used to provide investment incentives to benefit certain activities, often involving government equity, and frequently also supported by import protection, initially in the form of bans and quotas, but subsequently converted to high tariffs by the mid-1990s. Many of these income tax and other duty exemptions, such as for pioneer industries, have been recently abolished, and the Government has announced plans to cut and rationalize the use of incentives.

3. Apart from tariffs, very few formal trade barriers are faced by imports, except for fruit, vegetables and animal and related products, which are subject to strict quarantine regulations, including blanket bans. There are no import quotas, and only a small number of items are prohibited or subject to licensing, mainly for health or safety reasons. Similarly, although PNG's main exports of agricultural and resource-based products are licensed, they are generally free from quantitative or price controls; exceptions involve logs and fish where harvesting limits are applied in the interests of sustainable management. Exports of a wide range of manufactured products are eligible for financial assistance in the form of income tax holidays and other tax concessions.

4. The Government plays a major role in the development of natural-resource projects. In mining and petroleum projects, for example, the Government usually exercises its legal option of taking, at exploration cost, an equity share (of up to 30%) either directly or indirectly through its 51% ownership of Orogen Minerals. In addition, higher standard income tax rates apply to mining and petroleum projects, and additional taxes apply on profits above set rate-of-return thresholds. Domestication of the country's fish, forestry, and mineral resources is a key government policy objective.

5. Many staple products, such as rice, and utility services remain subject to price controls, although some, such as on beer, have been lifted in recent years. There are many state-owned enterprises and statutory authorities, some of which have monopoly rights. Until recently, government-funded price stabilization schemes, involving historically large payouts to support minimum export returns, applied to principal export tree crops of coffee, cocoa, copra and oil palm. The Copra Marketing Board retains exclusive rights to the domestic and export marketing of copra and coconut products.

6. Most state-owned enterprises and non-mining joint ventures have performed poorly. The Government intends to privatize many of the main statutory commercial enterprises, including those supplying key utility services; for example, it intends to deregulate the telecommunications industry from 2002 with PANGTEL being recently established as the statutory regulator. Privatization,

accompanied by improved corporate governance, could enhance competition within the economy, thereby making it more attractive to foreign investment and fostering long-term development.

(2) MEASURES DIRECTLY AFFECTING IMPORTS

(i) Registration, documentation and customs administration

7. There are minimal registration requirements for importers in PNG. Importers must have a tax file number to declare on importation. Customs agents must also be licensed and are required to lodge a bond with the Internal Revenue Commission to be used if necessary to meet duty defaults by clients on cleared goods.

8. The documents generally required for commercial importation are the invoice, bill of lading, and packing list. All goods are entered through customs using a single administration document (Form 15) and valuation forms (F53 and F54). Clearance through customs at ports normally takes from three to five days, although longer delays can occur if the shipment is subject to investigation. A pre-clearance system operates for airfreight, which releases about 90% in advance. PNG is considering the feasibility of acceding to the Customs Convention on the A.T.A. Carnet System for the Temporary Admission of Goods.

9. The ASYCUDA system has been used at the major ports of Lae and Port Moresby since 1994, and was introduced at Madang in 1999.¹ It is to be extended to Kimbe and Jackson's Airport at Port Moresby shortly, as well as to Vanimo, Alotau, Rabaul and Lihir by March 2000. The system is also being upgraded from version 2 to ASYCUDA++.

10. Reports of poor customs administration continue, with claims of inconsistent application of regulations and discretionary decision-making by customs officers. Appeal procedures on customs matters, contained in the Customs Act (sections 177 and 178), are rarely used; they can be cumbersome and subject to relatively long delays. The Government intends to revise the customs legislation to introduce better appeal provisions, and to restructure the Internal Revenue Commission to provide improved appeal facilities. PNG also plans to introduce an advance ruling system for customs classifications by 2000.

11. PNG authorities are taking steps aimed at improving customs procedures to help facilitate trade. They intend to make procedures and customs rulings more transparent. Customs procedures are being reviewed in accordance with the Kyoto Convention (the International Convention on the Simplification and Harmonization of Customs Procedures) as part of PNG's APEC involvement.

(ii) Tariffs and surcharges

12. PNG adopted the Harmonized System in January 1991, disaggregated to the eight-digit level. It contains approximately 5,400 tariff lines. The amended 1996 version was endorsed by Parliament in December 1996. All imports are dutiable at MFN rates, except mainly for tariff preferences extended to a relatively small range of goods imported from MSG members.

13. The Commissioners for Taxation and Customs and Excise are located within the Internal Revenue Commission, following the amalgamation in 1992 of the Taxation Office and the Bureau of Customs and Excise. The Commission is responsible for collecting tariffs and export taxes, excise

¹ ASYCUDA is an acronym for Automatic System for Customs Data. It is a computerized customs management system, devised by UNCTAD, that covers most foreign trade procedures, including the production of trade statistics. The system has been adopted by a number of developing countries.

duties levied on the sale, including imports, of certain goods, including certain "luxury" goods, and, as from 1 July 1999, the new VAT (section 4). Tariff rates are specified under the Customs Tariff Act 1990.

(a) General features

14. Tariffs have traditionally served dual purposes in Papua New Guinea: to raise government revenue, and to protect domestic production, especially infant or new industries, to meet the Government's import substitution policies. In taxing imports, tariffs provide a major source of government revenue. Very high tariffs were levied on many goods, including motor vehicles, whether or not produced at home, primarily to raise revenue. Tariffs on imported substitutes also protect domestic industries by raising the price of imports. Meeting these two objectives resulted in a highly distorted tariff structure with high rates and wide disparities in rates. This impaired economic efficiency by distorting the economy's resource allocation and thereby reducing national welfare (Box III.1). PNG's manufacturing sector largely stagnated under such high tariff protection, and infant industries continued to be inefficient despite being in existence for some 20 years.

15. Trade taxes on imports and exports are an important source of government revenue in Papua New Guinea, providing on average around one third of total tax revenue during the 1990s, declining since 1995 to an estimated 28% in 1998 (Chart III.1). Most came from import tariffs, which accounted for one quarter of total tax revenue in 1998, up from 22% in the previous two years.² Although export taxes increased in relative importance during the 1990s, the share began to decline in 1995, and especially since 1997 due to the drop in world prices and export taxes on logs. This share is expected to drop to around 3% in 1998 due to reduced log exports and tax rates.

16. Tariff policy is currently the responsibility of the Internal Revenue Commission, which is in the portfolio of the Minister of Finance (now Treasury and Planning). Until recently, all tariff rate and other changes to the PNG Customs Tariff Act 1990 required legislative amendment through Parliament. Tariff reductions, but not increases, can now be made by government without parliamentary approval. Tariff rates have been changed regularly in annual budgets.

17. Tariffs generally increased during the 1970s and 1980s, when tariff setting was generally ad hoc. Import duties were raised across-the-board in the March 1994 mini budget and in 1995. Rates however tended to change erratically, often reversing earlier amendments. For example, average tariffs on four key categories of agricultural inputs rose from 7.5% in 1987 to 8.5% in 1989, fell to 5% in 1990, and to zero in 1991 and 1992, before increasing to 10% in 1993 and 11% in 1994. These duties were reduced to 8% in November 1995 and to 5% in January 1997. This ad hoc approach to setting tariff rates created many anomalies, with closely related products in consumption or production being subject to substantially different duty rates. This introduced unnecessary distortions into the tariff and added to the efficiency costs from tariff protection.

18. No additional charges are levied on imported goods (apart from excise taxes, which are also applied to domestic goods, if produced, and the VAT since 1 July 1999). A temporary import duty surcharge of 1.5%, introduced in the 1998 Budget as a drought relief measure and extended in the 1999 Budget, was terminated on 1 July 1999 when the tax reforms commenced. This surcharge applied to all dutiable imports.

² In 1980 tariffs represented 16% of total internal revenue.

Box III.1: The advantages of lower, more uniform tariffs

The extent to which a country's efficiency of resource use is reduced by its tariff structure will depend upon both the level of duties and the degree of non-uniformity between these rates. For any given average tariff rate, the wider the disparities in duty levels, especially between goods that are close substitutes in both consumption or production, the more distorting will be the tariff structure. Thus, a movement towards a lower and more uniform tariff would be expected in general to improve resource allocation and raise economic welfare. This is because a uniform tariff structure will have less influence on the private decisions by producers and consumers, and allow resources to be directed more by market outcomes.

A non-uniform tariff is often supported on the grounds of providing a cascading or escalating tariff to encourage downstream processing. Such a tariff structure provides much lower duty rates on raw materials with progressively higher tariffs being applied through to the final processed product. However, by providing greater incentives to produce downstream products, an escalating tariff risks generating inefficient activities that become dependent on government assistance. What may be mild escalation in nominal tariff terms can provide very high effective (net) assistance to downstream activities. For example, a firm facing an average tariff duty on inputs of 10% and producing an output protected by a 50% tariff, would receive a rate of effective protection anywhere from 50% to over 500%, depending on the activity's "free trade" value added. They may on occasions be value subtracting when inputs and outputs are priced at international, rather than assisted, levels.

High and disparate tariffs foster inefficiency and penalize efficient activities, including export industries, by promoting a high-cost economy, thereby impairing the competitiveness of exporters. Taxes on imports are, in effect, shifted onto exports.

As well as promoting efficiency gains, a low uniform tariff is simpler and easier to administer. It removes many of the incentives for making false customs descriptions and classifications. Moreover, by treating all producers and importers equally, it is likely to reduce lobbying or "rent seeking" pressures on the Government and make it easier to reject pleas for special treatment.

It is often argued that reducing duty rates to adopt a lower more uniform tariff would entail a substantial reduction in government revenue compared to a current system of high tariffs, especially on consumer and so-called luxury goods. However, this need not be the case. At lower rates, evasion of tariffs is reduced. Import volumes will also increase, as domestic consumers purchase more and local suppliers produce less. This shortage in domestic production will be met by imports. As tariffs are lowered, it is possible that import quantities could rise sufficiently to raise tariff revenue, depending upon market conditions. This would especially be the case if special duty exemptions and concessions, which are usually associated with high and disparate tariff structures, were also eliminated. Such concessions themselves are liable to make the tariff structure more disparate and undermine transparency and economic efficiency.

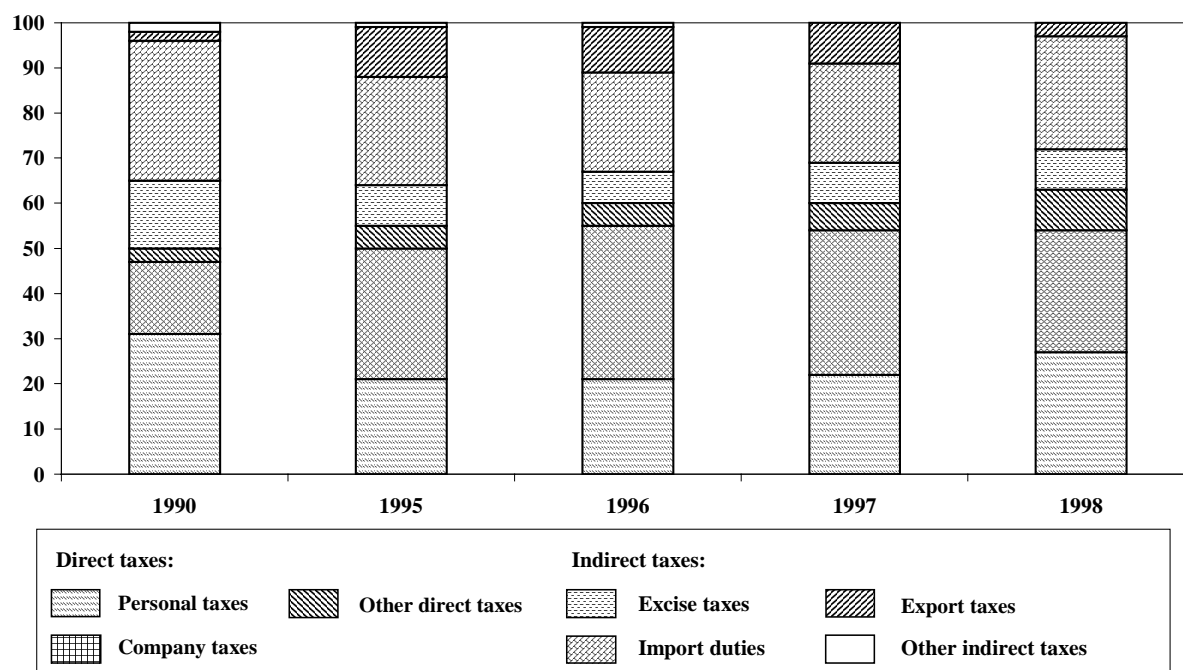
The above analysis suggests that uniform tariffs should be a policy goal, even though demand elasticities (a measure of the extent to which demand for a product varies with changes in price) will differ across goods. Although setting higher tariffs on those products with inelastic demand (small responsiveness to price changes) may in principle distort welfare less and maximize tariff revenue, tariff uniformity remains desirable industry and tax policy objectives. This is because trying to set tariff levels according to differences in demand elasticities is in practice a high-risk strategy given that empirical measures of elasticities are inevitably imprecise, and the potential resource costs of getting it wrong are high. Thus, tariff uniformity is a sensible "rule of thumb" policy goal on efficiency grounds, and is also desirable on grounds of transparency and administrative simplicity.

Using high tariffs to raise government revenue adversely affects economic efficiency. Tariffs tax only foreign products. A true consumption tax, such as a conventional VAT, would be non-discriminatory and tax imports and domestically produced goods equally. Thus, the protective effect of tariffs can be removed by converting them to a true consumption tax by extending the same duty to domestic products (although in practice many of these goods will not be produced locally). Although a consumption tax and a tariff both raise prices of domestically produced goods, tariffs benefit home producers by enabling them to sell at a higher price equal to the duty-paid import price, whereas consumption taxes accrue to the Government as revenue.

Source: WTO Secretariat.

Chart III.1
Government revenue structure, 1990 and 1995-98

Per cent of tax revenue



Source : Bank of Papua New Guinea, *Quarterly Economic Bulletin* (various issues).

(b) Tariff reduction programme

19. Under the Government's structural adjustment programme, an eight-year programme of phased tariff reductions (three years longer than the five-year programme initially announced in 1995) was introduced from 1 July 1999, as part of a package of tax reforms which included the introduction of a VAT.³ The programme reduced the number of tariff rates immediately from six to four by lowering the "basic" and "input" tariffs on raw materials and capital goods from 5% and 11% to zero (Table III.1). Other rates were reduced immediately from 40% to 30% on intermediate goods (the "intermediate" rate); from 55% to 40% on protected goods (the "protective" rate); and to 55% for duties that previously ranged from 75% to 125% (the "prohibitive" rate). These new rates are to be further phased down in three equal cuts of five percentage points to 15%, 25% and 40%, respectively, by 1 January 2006. The programme, passed by Parliament in 1998 as the Tariff (Tariff Reform 1998) Act 1997, was initially to have begun on 1 January 1998, and then on 1 January 1999, following the Government's White Paper on the Tariff Reform Programme presented to Parliament in late 1998. It was subsequently delayed for a further six months in tandem with the introduction of the VAT. The tariff reforms were an important component of the tax reforms.

³ A previous reform programme announced in 1992 to apply a uniform tariff of 10% (with exemptions for all capital inputs used in export activities and for essential foods), and a protective rate of 30% was never implemented.

Table III.1
Tariff reduction programme, July 1999 to 2006
(Per cent)

Tariff category	Pre-1 July 1999 ^a	1 July 1999 – 30 Dec. 2000	1 Jan. 2001 – 31 Dec. 2002	1 Jan. 2003 – 31 Dec. 2005	1 Jan. 2006
Free	0	0	0	0	0
Input rate	5	0	0	0	0
Basic rate	11	0	0	0	0
Intermediate rate	40	30	25	20	15
Protective rate	55	40	35	30	25
Prohibitive rate	75-125	55	50	45	40

a Excludes temporary tariff surcharge of 1.5%, which was abolished on 1 July 1999.

Source: Government of Papua New Guinea.

20. The tariff reductions were based on a line-by-line review of tariff rates by the Internal Revenue Commission, following wide consultations with industry. The new tariff rates were structured to provide "prohibitive" and "protective" rates — and sometimes the "intermediate" rate — on imports competing with domestic goods, or where production was considered possible (Table III.2). Other goods, including especially inputs, were made free or subject to the "intermediate" rate. Tariff reductions were made in some cases on final goods because producers would have benefited from lower costs due to reduced tariffs on major inputs.

Table III.2
Main areas of tariff protection, July 1999 to 2006
(Per cent)

HS 2-digit	Main areas of tariff protection	Tariff range	
		Pre-July 1999	2006
2	Prohibitive rate on poultry meat & pork; intermediate rate on bovine meat; specific duty on poultry	11-40	0-15
3	Protective rate on all fish & crustaceans; bait duty free as an input to fishing	11-55	0-25
4	Specific duty on eggs to protect local industry by avoiding dumping; protective rate on natural honey	11-55	0-25
5	Protective rate on feathers, ivory, shell & coral	11-40	0-15
6	Protective rate on cut flowers, foliage & branches for bouquets	0-55	0-25
7	Protective rate on all fresh, prepared & preserved vegetables	11-75	0-40
8	Protective rate on fresh & preserved fruit & nuts eg cashew nuts, bananas, pineapples, avocados, melons	11-55	0-40
9	Protective rate on coffee, tea & some spices e.g. dried or crushed chillies, vanilla, cardamom & ginger	40-55	15-25
11	Intermediate rate on flour products produced domestically	11-55	0-15
12	Protective tariff rate on peanuts & copra; intermediate rate on other products e.g. palm nuts & sugar cane	11-40	0-25
13	Prohibitive rate on vegetable saps and extracts of opium	11-55	0-40
14	Intermediate rate on vegetable materials for plating	11-55	0-15
15	Protective rate on palm oil, copra oil & palm kernel	11-55	0-15
16	Protective rate on preparations of meat & crustaceans; higher tariffs on canned mackerel (govt agreement)	8-90	0-25
17	High sugar tariffs (government agreement); protective rate on sugar confectionery	40-85	0-40
18	Protective rate on chocolate bars & confectionery; intermediate rate on cocoa & cocoa products	40	0-25
19	Protective rate on food products e.g. instant noodles, crisps; intermediate rate on other products e.g. pasta	11-40	0-25
20	Protective tariff on all preparations of vegetables, fruit & nuts; baked beans	11-40	0-25
21	Protective rate on coffee & tea extracts, ice cream & cordials	11-55	0-25

Table III.2 (cont'd)

HS 2-digit	Main areas of tariff protection	Tariff range	
		Pre-July 1999	2006
22	Protective rate on mineral & aerated waters, beer & spirits; composite rates protect against dumping	0-125	0-40
23	Intermediate rate on animal feed	11-55	0-15
24	Composite rates to protect against dumping	11-125	40
25	Intermediate rate on cement	5-40	0-15
28	Intermediate rate on sodium hypochlorine (produced locally as bleach)	5	0-15
32	Intermediate rate on paint, lacquers & varnishes	11-40	0-15
33	Intermediate rate on cosmetics & toiletries	11-55	0-15
34	Protective rate on soap, detergents, bleaches & candles	11-55	0-25
35	Intermediate rate on glues & adhesives	11-40	0-15
38	Protective & intermediate rates on disinfectants & room deodorisers	11-55	0-25
39	Protective rate on plastic shopping bags; intermediate rate on plastic goods e.g. pipes, hoses, plastic bottles	11-55	0-25
41	Protective rate on crocodile skin & leather	11-55	0-25
42	Protective rate on leather articles	11-55	0-25
43	Intermediate rate on furskin articles	11-40	0-15
44	Prohibitive rate on plywood, wooden frames, pallets & carpentry; intermediate rate on wood board	40-100	0-40
46	Protective rate on mats, screens & baskets	11-40	25
48	Protective rate on printed envelopes & toilet paper; intermediate rate on corrugated paper & paperboard	11-55	0-15
49	Protective rate on postcards, calendars, catalogues	0-40	0-15
56	Intermediate rate on fishing nets	11-40	0-15
57	Intermediate rate on carpets & textile floor coverings	55	15
58	Intermediate rate on lace, tapestries, braids & embroidery	11-40	0-15
59	Intermediate rate on wallpaper & textile wall coverings	11-40	0-15
61	Protective rate on knitted or crocheted clothing	409	15-25
62	Protective rate on clothing to assist production	11-40	15-25
63	Intermediate rate on all made-up textile articles	11-40	0-25
64	Intermediate rate on footwear produced locally	11-40	0-25
65	Intermediate rate on headgear	11-40	0-15
66	Intermediate rate on umbrellas	40	15
67	Protective rate on artificial flowers	11-55	0-15
68	Protective rate on cement pipes, prefabricated structural components, panels, boards, tiles & blocks	11-75	0-25
69	Intermediate rate on ceramic tableware & kitchenware	11-55	0-25
70	Protective rate on framed mirrors to protect carpentry industry; intermediate rate on unframed mirrors	11-40	0-25
71	Protective rate on jewellery	0-55	0-40
72	Intermediate rate on corrugated iron or steel	5	0-15
73	Protective or intermediate rate on products produced locally	11-55	0-25
74	Intermediate rate on household copper articles	11-40	0-15
75	Intermediate rate on nickel articles	11-40	0-15
76	Intermediate rates on aluminium kitchen & household articles	5-40	0-15
78	Intermediate rate on vats, reservoirs & drums	11-40	0-15
79	Intermediate rate on certain zinc articles	11-40	0-15
80	Intermediate rate on tin vats, reservoirs, drums & household articles	11-40	0-15
82	All hand tools & cutlery imported duty free	11-55	0-40
83	Protective rate on sign-and-name plates, crown forks, statuettes & bells; intermediate rate on mountings	11-55	0-25
84	Protective rate on special machinery items	11-55	0-25

Table III.2 (cont'd)

HS 2-digit	Main areas of tariff protection	Tariff range	
		Pre-July 1999	2006
85	Intermediate rate on primary cells & batteries plus lead-acid for piston engines	5-55	0-15
86	Duty-free inputs	11	0
90	Intermediate rate on camera lenses & binoculars	0-55	0-15
91	Duty-free inputs	11	0
92	Duty free	11	0
93	Duty free	55	0

Source: Government of Papua New Guinea (1998), *White Paper on the Tariff Reform Programme*.

21. Tariff reductions were also partly financed by applying excise taxes on certain designated luxury items to replace in part the high tariffs on these products. For example, new passenger motor vehicles, which were previously dutiable at a tariff of mainly 75% when imported, are from 1 July 1999 duty free but subject to an excise duty of 60% plus the 10% VAT, whether imported or not (although in practice all vehicles are imported). The excise duty was raised to 110% on passenger motor vehicles with engine capacity of 2,800 cc and above in the 1999 Supplementary Budget.

22. The tax reform package was to be approximately revenue neutral. The Government estimated that the tariff reductions would reduce revenue by K 132 million in the first full year (1999-2000), but that this would be offset by some K 77 million by additional revenue from the VAT and excise tax changes. This would enable the Government to compensate provinces for lost sales tax revenue.

23. The tariff and tax reforms should improve economic efficiency by substantially reducing the unweighted average tariff rate from 20% - excluding the temporary surcharge duty of 1.5%, which was abolished on 1 July 1999 - to 9% currently, and to 5% in 2006. The dispersion in duty rates has also been narrowed immediately from a standard deviation of 19 to 17 percentage points, and will fall further to 10 percentage points in 2006 (Table III.3).⁴ The average unweighted tariff in 1995 was 32%. Since the major cuts in tariffs mainly affected lower duties initially, including the cuts on basic and input tariffs to zero, the immediate reduction in the average tariff rate is much more pronounced than the decline in dispersion. These reforms will help redress the discrimination provided by the tariff against export activities.

24. The new tariff structure has increased the share of duty-free lines from 3% to 77% (Chart III.2). Nevertheless, it provides long-term tariff assistance at maximum rates of 25% and 40% designed to protect a number of goods produced domestically, accounting for almost 15% of tariff lines in 2006 — albeit substantially down on the previous share of 30% of tariff lines subject to rates of 40% and above (Chart III.2). A few goods with high tariffs, namely alcoholic beverages, sugar, tinned mackerel, plywood, and tobacco products, have also been given preferential treatment under the tariff reduction programme because of contractual obligations by the Government with domestic producers (Table III.4). Although the number of products left with relatively high tariffs in 2006 will be relatively small, they comprise a significant share of domestic production and are likely therefore to have a substantial impact on resource allocation and the economy's overall economic efficiency.

⁴ These average tariff rates are derived from scheduled applied MFN rates and therefore exclude the effects of tariff concessions and exemptions.

Table III.3
Tariff structure 1999 and 2006
(Per cent and percentage points)

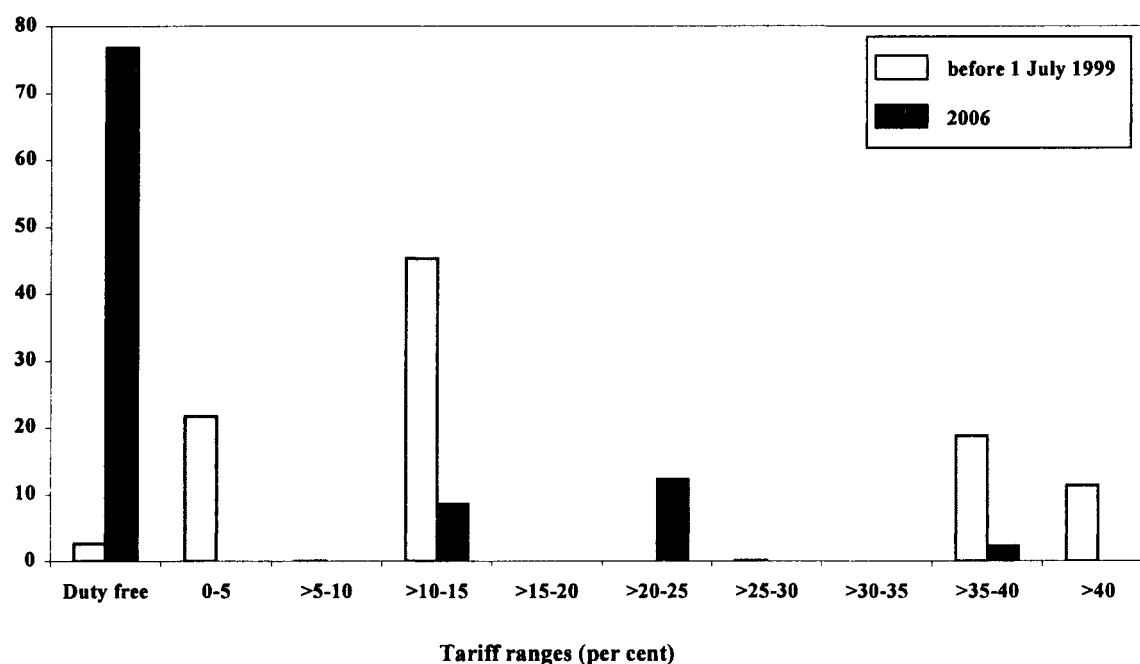
ISIC categories	Unweighted tariff average			Standard deviation		
	Pre-1 July 1999	1 July 1999 – 31 Dec. 1999	1 Jan. 2006	Pre-1 July 1999	1 July 1999 – 31 Dec. 1999	1 Jan. 2006
Agriculture, hunting, forestry & fishing	37.8	24.6	15.8	22.1	21.4	15.0
Mining and quarrying	13.4	0.0	0.0	10.2	0.0	0.0
Manufacturing	19.5	8.0	4.7	18.5	15.9	9.6
Total	20.4	8.8	5.3	19.1	16.6	10.2
By stage of processing						
- unprocessed	30.0	16.2	10.3	21.6	20.5	13.7
- semi-processed	13.3	2.9	1.6	15.0	11.6	6.3
- fully processed	22.3	10.4	6.3	19.3	17.0	10.5

Source: WTO Secretariat calculations, based on information provided by the authorities of Papua New Guinea.

Chart III.2

Distribution of tariff rates, before 1 July 1999 and 2006

Per cent of total tariff lines



Note: Before 1 July 1999, the share of total tariff lines for >5-10 and >25-30 represents 0.1% for each.

Source: WTO Secretariat calculations, based on information provided by the authorities of Papua New Guinea.

Table III.4
Products subject to different treatment under the tariff reduction programme
(Per cent)

Product description	Pre-1 July 1999	1 July 1999 – 31 Dec. 2000	1 Jan. 2001 – 31 Dec. 2002	1 Jan. 2003 – 31 Dec. 2005	1 Jan. 2006
A. Products subject to preferential phasing arrangements					
Cane or beet sugar	85	82	76	70	40
Tinned mackerel	90	70	50	20	15
Plywood, veneered panels and similar laminated wood	100	95	85	75	40
Beer	125	55 or K 2.20/litre	50 or K 2.15/litre	45 or K 2.15/litre	40 or K 2.10/litre
Other fermented beverages	K 1.00/litre	55 or K 2.20/litre	50 or K 2.15/litre	45 or K 2.15/litre	40 or K 2.10/litre
Spirits and liqueurs	55	55 or K 14.00/litre	50 or K 14.00/litre	45 or K 12.00/litre	40 or K 12.00/litre
Cigarettes	125	55 or K 40.00/litre	50 or K 40.00 /kg.	45 or K 35.00/kg.	40 or K 30.00/kg.
Certain other manufactured tobacco products	125	55 or K 15.00/litre	50 or K 15.00/kg.	45 or K 10.00/kg.	40 or K10.00/kg.
Twist tobacco	25	55 or K 15.00/kg.	50 or K 15.00/kg.	45 or K 10.00/kg.	40 or K10.00/kg.
B. Products subject to immediate removal of high tariffs					
					Pre-1 July 1999 rate
Live cats, dogs and birds; cream & yoghurt; human & pig hair; rice flour & certain malt; certain animal fats & oils; certain cocoa preparations; malt extract; food sauces & ice cream; acorns & horse chestnuts; lubricating oils & certain gases; certain fruit; glazier's putty; perfumes, polishes, creams & modelling paste; miscellaneous chemical products, e.g. brake fluid, ink removers; certain plastics e.g. floor coverings, self adhesive strips, drinking cups; certain rubber products, cork; wood pulp & certain paper products; certain printed matter; worn clothing & rags; certain glass products; & certain miscellaneous products.					40
Poker machines & certain toys					150, 40
Photographic plates; precious stones & metals; & certain furniture					55
Certain vegetable saps & vegetable products; ferro-cenum & other pyrophoric alloys; densified wood, ice cream sticks; worked mica & other articles; air conditioners, vending machines & freezers; electrical parts for TVs, etc.					55, 40

Source: Compiled by WTO Secretariat, based on information supplied by the Government of Papua New Guinea.

25. Tariff rates, on average, in 2006 will remain over three times as high on agricultural products than on manufactured goods, at 16% compared to 5%. Prior to the reforms, the average tariff on agriculture was only about double that of manufacturing. Thus, average tariffs on agriculture are being reduced by almost 60% compared with a 76% reduction for manufacturing, while mining, previously with average tariffs of 13%, now receives zero tariff assistance. This indicates that the discrimination in the tariff against the manufacturing and mining sectors will increase and that these sectors overall have incurred the greatest tariff cuts. However, this must be qualified by the fact that some items of manufacturing, including certain processed foods and timber products, have retained relatively high tariffs compared to many other manufacturing activities.

26. The immediate removal of tariffs on imported raw materials and capital inputs would have reduced the drop in effective rates of protection for certain manufacturers caused by reductions in high tariff rates on final goods. Under the reforms, some tariffs on final goods (output tariffs) were reduced to offset the benefits flowing to domestic producers from lower input tariffs. It is conceivable that effective protection may not have fallen significantly (or may have even increased) for manufacturers of certain products subject to low reductions on output tariffs relative to their input tariffs, at least in the short term until output tariffs fall further.

27. Some tariffs of 55% and mainly of 40% were not subject to phased reduction but were reduced immediately to zero from 1 July 1999 (Table III.4). These generally occurred on products

that are not produced locally or considered viable. A few other products also incurred accelerated reductions. These included certain carpentry and joinery products, where tariffs of 100%, 75% and 55% were reduced immediately to 40%, to be phased down to 25% in 2006; and certain stone and cement panels, on which tariffs were reduced immediately from 75% to 40%, to be phased down to 25% in 2006.

28. At the same time, tariffs were increased on a number of manufacturing and agricultural goods reclassified so as to provide pockets of increased protection (Table III.5). Tariff rates on these products were mainly increased from 11% to 30% or 40% on 1 July 1999, and although being phased down under the programme, most duties will remain above the pre-1 July 1999 rate in 2006. The Government foreshadowed the similar reclassification of new goods, to receive increased tariffs, if they needed protection to be produced in PNG.

Table III.5
Tariff increases, 1 July 1999
(Per cent)

Product description	Pre-1 July 1999 tariff rate	1 July 1999 tariff rate
Other foliage for wreaths	Free	40
Artificial wreaths	Free	30
Onions & shallots	40	55
Hams, cuts, shoulders of pork & kangaroo, chocolate milk & yoghurt drinks; residual carbon products; vegetable plaiting materials	11	40
Animal & vegetable fats & oils; prepared sardines & tuna; bakers' mixes; prepared baking powders; other vegetable materials; non-dog and cat animal feed; lacquers & varnishes; propylene plates & sheets; baths & basins; other plastic packaging articles; plastic reservoirs, tanks; writing paper; clothing labels & badges; sacks & bags of jute, cotton & man-made fibres or other textile materials; bridges & sections; kitchenware parts; battery parts; tanker trailers & semi-trailers & other trailers & semi-trailers	11	30
Zinc-coated corrugated steel	5	30
Fermented beverages	K 1.00/litre	55 or K 2.20/litre
Spirits	11	55 or K 14.00/litre

Source: Compiled by WTO Secretariat from information supplied by the Government of Papua New Guinea.

29. Several tariff rate changes were announced in advance in the 1999 Budget, including on sugar, cement, plywood, and canned mackerel. These were subsequently reduced to 76%, 40%, 95% and 70% from 1 July 1999. At the same time, a higher tariff of 100% was set on imported used cars, compared with a tariff rate on new cars of zero from 1 July 1999 (previously 75%).

30. Since the 1996 Budget, 99% of tariff lines have been *ad valorem*. Most will be maintained in the reform programme, except mainly for imported live poultry, which is now duty free and no longer subject to a specific rate. They are mainly found on agricultural products and beverages, where some 94% of tariff lines have *ad valorem* duties. Specific rates apply on imported eggs, poultry offal, beer concentrate, tobacco, and matches; and alternate duties, applying whichever rate is the higher, on bottled water, beer, spirits, and certain other alcoholic beverages and tobacco products. These non-*ad valorem* duties are to be phased down significantly by 2006.

(c) Tariff escalation

31. The long-term escalating tariff structure, with rates ranging from free to 40% in 2006, is intended to encourage downstream processing. However, when the rates to apply in 2006 are averaged across processing stages, it appears that the reforms will make the PNG tariff structure more

de-escalating overall, and in particular between unprocessed and semi-processed products. Tariffs are, on average, lower on semi-processed and processed goods than on unprocessed products. The current average tariff on unprocessed products is 16% compared with 3% on semi-processed goods and 10% on fully processed products (Table III.3); in 2006, the average tariff rates will be 10%, 2% and 6%, respectively. Thus, the tariff structure tends to discourage downstream processing of unprocessed products, while encouraging the processing of semi-processed products. Since PNG is primarily a resource-based economy, this structure would appear unsuited to its longer term competitive base of processing unprocessed products. A more neutral tariff structure between different stages of processing that does not discriminate against processing unprocessed products would be economically more efficient.

(d) Tariff bindings

32. Papua New Guinea bound its entire tariff schedule during the Uruguay Round. Agricultural products were bound at a general rate of 45%, to be implemented by 2004, and other products at 40%. However, a small group of items were bound at lower rates, mainly 11%, 20% and 30%, while very much higher bound rates, mainly 55%, 75% and 100%, were applied to a larger group of agricultural products including nuts, certain vegetable oils, and sugar. These bound rates are to be implemented over variable time periods. The tariff reduction programme was aimed at meeting PNG's commitments on tariff bindings. However, during the programme, tariff rates on a few non-food manufactured products may be above the bound level of 40%.

33. The Government intends to lower the general bound rate on manufactured products to 30% by 2006. Meeting this objective would require further reductions in the top tariff rate of 40%, which will apply in 2006 at the end of the current programme.

(e) Tariff preferences

34. Papua New Guinea applies MFN tariffs on imports from all countries except the Solomon Islands, Vanuatu and more recently Fiji, from which eligible imports are duty free under the MSG Trade Agreement (Chapter II). Some additional imports from Fiji are imported duty free, from 1 July 1999, following removal of the concessional 10% tariff.

(f) Tariff concessions

35. Several schemes operate to provide tariff concessions. The Customs Act provides 24 classes of tariff exemptions. Some cover specific infrastructure projects, while others are either organization-specific or use-specific, such as for the Lae Mackerel cannery and specialized mining equipment. Others are more general, and are considered on a case-by-case basis following consultations with the ministers concerned, such as granting new manufacturers duty-free imports of capital equipment. Requests for tariff exemptions are handled by the Internal Revenue Commission, for final approval by the Minister of Finance (now Treasury and Planning). Once authorized, the tariff exemption order is gazetted.

36. Specialized mining and petroleum capital equipment that is not readily available in PNG is exempt from duty for temporary importation in an approved use. The importer must lodge a security and undertake to re-export the equipment when the period has elapsed. Mining and petroleum firms also benefited from an Average Import Duty Rate Scheme, which capped the duty on imported inputs to an average tariff rate of 14.62% set with reference to the rates applied to a basket of nominated products. The Lihir, Ok Tedi, Mesima and Porgera gold mining projects and the Kutubu petroleum project were granted this average duty rate on a range of imported inputs.

37. Imports of aircraft and parts by a PNG registered company with a PNG airline operator's licence are duty free. Similarly, a PNG registered shipping company may import all ships duty free, including boats, ferries, tankers, and fishing vessels but not pleasure craft. Registered PNG companies may also import marine engines and outboard motors of up to 40 hp duty free.

38. Until recently, the minister also had discretion to grant tariff concessions on imported inputs under the Pioneer Industries Act, and also in joint venture projects involving the Government.

39. The Government recognized that the past practice of providing largely discretionary tariff exemptions and remissions were undermining the transparency of the tariff regime, and making it more distorting. For example, government tariff exemptions to specific commercial and donor funded construction projects had undermined the growth of the private construction industry in PNG. As well as eroding customs tariff revenue in a discriminatory and at times obscure manner, they were open to misuse and political influence on behalf of vested interests in ways that harmed competition and efficiency. Import duty exemptions were estimated to be costing the Government around K 80 to 100 million annually in revenue forgone.

40. The Government announced in the 1999 Budget that all import duty exemptions would be removed and that the Pioneer Industries Act would be terminated in order to eliminate distortions in the market. Almost all import duty exemptions were removed in April 1999.

(iii) Tariff quotas

41. According to the authorities, Papua New Guinea does not have tariff quotas on any products.

(iv) Other levies and charges

42. The tax reform package introduced on 1 July 1999 placed greater reliance on excise taxes as a means of taxing consumption of certain products to raise revenue. Legislation was amended in 1996 to separate the excise element from the tariff and to explicitly apply excise taxes to imports. Previously, excise taxes were technically levied only on domestic products, but the tariff included an equivalent excise tax component. Excise taxes have been extended from mainly alcoholic beverages (beer, wine, and spirits), most fuels, and manufactured tobacco products, to cover designated luxury goods, such as motor vehicles. The 10% excise tax on soft drinks was removed on 1 July 1999. Excise rates have been *ad valorem* since 1996, except for specific duties on fuels.

43. Excise taxes are applied uniformly to imported and domestically produced goods and do not discriminate against imports. The tax base for imports is the c.i.f. value plus import duty. For domestic products, it is based on a prescribed "distributor price", which is tied to the actual distributor's selling price. For cigarettes and tobacco products, the prescribed distributor's price is the list price. In the case of beer, spirits, and soft drinks, the prescribed distributor's price is tied to the average selling price. The same excise rate applies to all alcoholic beverages; thus high-alcohol drinks have been taxed more lightly than low-alcohol drinks. However, the prescribed distributor's price on spirits was raised from K 9.23 per litre to K 12.90 per litre on 1 July 1999 to remove this differential taxation.

44. The tax reforms extended the coverage of excise taxes to motor vehicles and certain luxury goods to fully or partially replace tariffs. Excise rates currently range from 10% to 150%.⁵ Apart

⁵ Excise tax rates range from 150% on poker machines and certain other gambling machines; 110% on large-engined passenger motor cars; 60% on small-engined passenger motor cars, and arms and ammunition; 40% on precious stones and metals; 30% on pure-bred breeding horses, perfumes, rolls of film, certain drying

from alcoholic beverages and tobacco products, all excisable products are now free of import duty. For example, new passenger cars are now importable duty free, but subject to an excise duty of 60% (or 110% on large-engined passenger cars) following the Supplementary Budget; and poker machines are importable duty free, subject to an excise tax of 150% — equal to the previous import duty. Excise duties on fuels, alcoholic beverages, and tobacco products were also raised in the 1999 Supplementary Budget.

45. The substitution of excise duties for tariffs on designated luxury goods will reduce the degree of tariff protection provided to existing or potential domestic producers of such products, while still taxing consumption. While both tariffs and excise (or sales) taxes raise domestic prices, tariffs differ by discriminating against imports. Whereas tariffs protect domestic producers by enabling them to charge higher prices than they could otherwise, excise (and sales) taxes afford no such protection, since they apply to imported and domestically produced goods alike. Thus, while domestic producers tend to be the main beneficiaries of tariffs, the Government gains from excise (and sale) taxes. The reformed tax structure should, therefore, enhance economic efficiency. However, excise taxes are best restricted to final consumer goods and not intermediate inputs to ensure that only consumption, and not production, is taxed. This can be a problem where excise taxes are applied on products that are both consumed and used as inputs into production, such as fuels and motor vehicles.

46. Another cornerstone of the tax reform package was the introduction of a 10% VAT (see section 4).

47. Licence fees are charged for permits covering several activities, such as for fishing vessels and for foreigners obtaining work permits. These were increased in the 1999 Budget from K 50 to K 1,500 for a three-year permit, and new permits were introduced for expatriate employees of family-run foreign-owned businesses costing K 5,000 annually to encourage such businesses to employ Papua New Guineans.

(v) Preshipment inspection

48. The Government instituted a preshipment inspection system in 1997 on imports (and exports). The declared values and classifications of imports are checked, including physical inspection of goods in the foreign port of export and upon importation. These arrangements are compatible with WTO requirements. These services are supplied by a private contractor, Société Générale de Surveillance (SGS).

(vi) Customs valuation

49. Since 1990, tariffs have been levied on the c.i.f. (cost, insurance and freight) value rather than the f.o.b. (free on board) value of imports. Without changing tariff rates, this increased duty collections and also raised the level of tariff protection afforded domestic industries by some 15%.⁶

50. Papua New Guinea became a member of the World Customs Organization in 1998. The Government is also implementing the WTO Agreement on Customs Valuation. PNG uses six customs valuation methods, the main one being the transaction value method. This is the export price

machines, certain electrical appliances, such as sound equipment and microwave ovens, certain optical equipment; and 10% on most transport equipment, except trailers.

⁶ The actual increase in tariff protection would have depended upon the difference between the f.o.b. and c.i.f. price of imports. This is given by the transportation costs of imports. The larger these costs, and hence the more the import's c.i.f. value exceeds its f.o.b. price, the more tariff protection would have been increased by the change in valuation.

paid by the importer adjusted in accordance with the customs legislation. The other valuation methods permitted in the legislation are "deductive", "similar", "identical", "computed" calculations, and "fallback". Where a customs valuation is in dispute, the goods can be cleared provisionally if the importer lodges either a bank guarantee or cash deposit as security.

51. PNG does not set any minimum import or reference prices for customs valuation. However, the fallback value method, the valuation method applied of last resort, applies certain set values.

(vii) Import prohibitions, quotas and licensing

52. Import bans and quotas were previously used to encourage domestic manufacturing industries, such as canned beef, sugar, cement, vegetables, flour, batteries and canned mackerel. These import bans and quotas were removed, mainly by 1996, and converted to protective and prohibitive tariff rates, ranging mostly from 30% to 80%, with some higher rates. The import ban on canned beef was converted to a tariff of 55% in 1994, for example, and the ten-year ban on sugar was replaced with a tariff of 85% in 1997.

53. According to authorities, PNG no longer operates any prohibitions or import quotas. Many of the high tariffs remaining and receiving special "phasing down" treatment are a legacy of "anti-competitive" arrangements negotiated by previous governments (Box III.2).

Box III.2: Examples of industries subject to special arrangements

These arrangements usually involved the Government effectively granting monopoly status by initially applying import bans and quotas, and more recently by converting these to high, often prohibitive, tariffs. Examples of industries protected in this manner in the past include:

- the cement plant at Lae, designated as the sole supplier of this vital input and supported initially by an import ban;
- the sugar refinery at Ramu, initially granted a ten-year import ban, and continues to produce refined sugar that is of poor quality;
- the mackerel cannery at Lae, provided with an import ban on canned mackerel;
- the corned beef cannery at Madang, initially granted monopoly production and import status which, after court action, was removed by the entry of a new cannery; both were supported by a seven-year import ban on canned beef.

These arrangements continue to inflate the domestic price of many key inputs, thereby penalizing downstream users and exporters.

Source: REPIM (1996), "Growth with Stability: Monetary and Fiscal Policy in Papua New Guinea", in Temu (ed), *Papua New Guinea: A 20/20 Vision*, National Centre for Development Studies, Australian National University, Canberra.

54. PNG maintains import licensing only to protect national health and security, such as on imports of dangerous drugs, pornographic material, and firearms; licences are issued by the Health Department and Police Department, respectively.

55. PNG bans the importation of certain pesticides for agricultural use, namely DDT, Chlordane, Dieldrin and Endrin, because of environmental concerns. As a party to the Montreal Protocol on

Substances that Deplete the Ozone Layer, it also bans imports of CFCs and other ozone-depleting substances. It also belongs to Basle Convention on Control of Transboundary Movement of Hazardous Wastes and their Disposal.

56. Import restrictions apply on wild fauna and flora under the Convention on International Trade in Endangered Species of Fauna and Flora (CITES). These are contained in the International Trade (Fauna and Flora) Act of 1979. The crocodile industry is regulated by the Crocodile (Trade and Protection) Act 1974.

57. PNG applies trade embargoes in compliance with UN Security Council Resolutions. However, there are presently no trade embargoes affecting PNG trade.

(viii) State trading and countertrade

58. Papua New Guinea is not involved in countertrade and has no state trading activities controlling imports. All trade is conducted under normal commercial terms.

(ix) Import cartels

59. There are no known import cartels operating in PNG according to authorities.

(x) Local-content requirements

60. According to authorities, Papua New Guinea has no local-content requirements for domestic production. Nevertheless, as discussed in Chapter IV, PNG maintains mandatory requirements for licensed foreign vessels fishing in its exclusive zone.

(xi) Rules of origin

61. The MSG Trade Agreement with the Solomon Islands, Vanuatu, and Fiji stipulates certain rules of origin requirements based on changes in HS (6-digit) classifications. These must be met for goods to receive preferential tariff access to PNG.

62. The Government intends to align national rules of origin with those of the World Customs Organization, and those of regional preferential tariff schemes. It has taken steps to issue origin certificates for PNG goods under regional trade arrangements.

(xii) Trade remedies

63. PNG has anti-dumping and subsidy provisions in its Customs Tariff (Dumping and Subsidies) Act. The Government may impose dumping duties on goods dumped below "normal value" and causing or threatening to cause injury to the domestic industry. The legislation permits anti-dumping action to be either on particular goods; goods exported from a particular country; goods contained in a particular shipment; goods exported by a particular exporter; or any other specification of goods. All dumping duties must be gazetted. However, according to authorities, PNG has not used such measures, although a recommendation to apply anti-dumping duties on cement imports is currently with the Government. The 1999 Budget also referred to the imposition of a levy of K 3 on imports of barracuda as an anti-dumping measure.

64. Alternate tariff rates with a floor specific duty have been applied to cigarettes, tobacco, beer, and spirits to guard against possible dumping practices. This specific duty rate is to be linked to

movements in the kina exchange rate. Specific duties have also been applied to some other products, such as eggs and poultry meat, to guard against the possible dumping of cheap products.

65. From 1 July 1999, ministerial responsibility for anti-dumping was shifted from the Minister of Foreign Affairs and Trade to the Minister of Treasury and Planning. Administration of the anti-dumping legislation now rests with the Internal Revenue Commission. Dumping of products is to be countered in future through the imposition of anti-dumping duties rather than the use of specific tariff rates.

(xiii) Measures implemented in exporting countries

66. The Government has no agreements with foreign governments or enterprises designed to influence the quantity or value of goods and services exported to Papua New Guinea. According to the authorities, no firm in PNG is party to any such VER arrangement.

(xiv) Other measures

67. Papua New Guinea does not maintain any surveillance measures on imports. It has declared several centres as free-trade zones. These are Vanimo, Daru, Buka and Kerema. All zones are in their early stage of development.

68. No import restrictions are, or have been, applied by PNG under WTO balance-of-payments provisions.

(3) MEASURES DIRECTLY AFFECTING EXPORTS

(i) Registration requirements

69. Exporters do not need to be registered but must have a tax file number.

(ii) Export taxes

70. Papua New Guinea imposes export taxes, principally for revenue purposes, on the f.o.b. value of a range of products, payable before shipment. Taxes of 5% apply to exports of sea cucumbers, mineral ores and concentrates, and crocodile skins⁷; 15% on rattan (cane), when exported unprocessed; and higher progressive rates on round logs. Exports of Sandalwood attract a flat rate tax of 15%. Export taxes were lifted on marine products, except for bêche de mer, in the 1997 Budget because of the decline in export prices.

71. Progressive export taxes on logs were introduced in 1996 comprising six incremental steps from a rate of 15% for logs valued up to K 90 per cubic metre f.o.b. to a maximum rate of 70% for logs valued over K 200 per cubic metre.⁸ These changes superseded a previously announced plan to replace export and other forestry taxes with a system of stumpage fees. Following the collapse in world prices in 1997, logs valued up to K 130 per cubic metre were exempt from export tax from July 1998, but this exemption was removed in the August 1999 Supplementary Budget. Export taxes, 95% of which come from logs, represented around 10% of government tax revenue. This was expected to fall to 3% for 1998.

⁷ The 5% export tax was removed in 1994 for gold and silver produced by small-scale alluvial miners. Under mining agreements, Bougainville, Ok Tedi, Misima, Porgera and Kutubu are not subject to export taxes on gold, copper, and crude oil.

⁸ Previously tax rates on logs were related to tree species and ranged from 26% to 46%.

72. Export taxes on unprocessed logs are seen as a means of capturing the resource rents associated with natural-resource-based products, and also to promote downstream value added. However, like import tariffs, export taxes are distorting. They are an inefficient means of taxing resource rents, such as from forests. Contrary to their intended effects, export taxes can also provide a disincentive to conserve natural resources by reducing domestic log prices and diminishing the economic value of forests. Export taxes compound the anti-export bias, albeit reduced significantly following recent reforms, inherent in PNG's tariff structure and its policy of supporting an over-valued kina. They also constitute assistance to inefficient domestic downstream processors by providing access to raw materials, such as round logs, at well below world prices. Such assistance is in addition to that accorded processed products, such as plywood, which also receive high tariff protection against imports (Box III.3). Export taxes are also prone to tax evasion through misclassification and under-declaration of f.o.b. values.

Box III.3: Promotion of downstream processing

Many developing countries, such as PNG, tax or ban exports of natural-resource-based commodities, such as logs, to promote greater domestic value added by encouraging downstream processing. The expectation is that these restrictions will boost economic activity by generating employment and raising export receipts, and help conserve forests. However, the efficacy of using export restrictions to achieve these economic and environmental objectives is questionable.

Taxing or restricting exports of the primary resource assists downstream processing by diverting export sales on to the home market. The domestic price is thus reduced by the export restriction, providing an implicit subsidy to processors and penalizing raw material suppliers. Domestic prices would be expected to fall by the full amount of the export tax, or where the taxes are prohibitive or export of the logs banned, by a potentially larger amount. Because export restrictions lower input prices, they can provide substantial effective rates of assistance to value added by downstream processors. This is particular the case for processed wood products that also receive high tariff assistance. Indeed, if the implicit input subsidy and tariffs become large enough, the downstream processed activity may subtract, rather than add value. Such inefficient processing would be economically undesirable and would risk frittering away the economy's natural resources without any lasting benefit to the country.

This is the case for plywood and other laminated boards in PNG, which continue to be subject to high tariffs of currently 95% (down from 100%) while also benefiting from the export tax on logs (Chapter IV).

Source: WTO Secretariat.

(iii) Export prohibitions, controls and licensing

73. Export permits and licences are required primarily for primary commodities, and are issued by the respective department responsible. For example, log exports require an export licence from the PNG Forest Authority, and are subject to guidelines on minimum export prices. Agricultural export licences are issued by the Department of Agriculture and Livestock, including for copra, cocoa, and coffee, and by the Department of Fisheries for marine products.

74. A log export-monitoring and surveillance scheme is provided by SGS to control avoidance of export taxes through under-invoicing or mis-specification of export amounts. The highly progressive structure of export tax rates increases the incentives for such evasion. Some 70% of log exports are covered by SGS surveillance. The Government is considering whether to continue using SGS.

75. Exports of certain unprocessed log species and raw rattan are banned. Banned logs are conifer, ebony, cordia, balsa, teak, rosewood and black bean, but these can be exported as sawn timber. These controls are again aimed at encouraging domestic processing.

76. Exports of flora and fauna may be prohibited or subject to license under the Convention on International Trade in Endangered Species (CITES). These are contained in the International Trade (Fauna and Flora) Act. This Act also lists native species for which export permits are not required for environmental reasons, and include mainly fish, crustaceans and several food crops, such as coconuts, sugar cane, and betel nuts (Schedule 4).

(iv) Export quotas and voluntary restraints

77. Papua New Guinea does not, according to its authorities, maintain export quotas or voluntary export restraints.

(v) State trading

78. The Copra Marketing Board, a wholly government-owned statutory trading company, has exclusive rights to the domestic and international marketing of copra as part of the Government's marketing arrangements.

(vi) Export subsidies

79. Papua New Guinea does not provide export subsidies per se. However, exports have benefited since 1984 from principally two income tax concessions that reduce tax payments on export profits. Export income is exempt from tax for the first three years of export. For the next four years, income growth above the average income level for the previous three years is also exempt. The income tax exemption is available to firms producing new manufactured products - as defined in the Industrial Development (Wage Subsidy) Act 1984 - or a wide range of other prescribed processed goods, such as food products.⁹ A double deduction for income tax purposes also applies to expenditure on export market development costs. This covers goods fully manufactured in PNG or with local labour costs exceeding 10% of the product's price. Unprocessed primary commodities and services, such as tourism, are ineligible.

80. These concessionary schemes target manufactured exports, and thereby discriminate against other exports, including non-processed products and services.

(vii) Duty drawback and tax concessions

81. The lack of an effective duty drawback system in PNG administered by the Internal Revenue Commission has compounded the anti-export bias of past import protection policies. Changes to the Customs Act in 1996 were aimed at accelerating the payment of duty refunds by allowing them to be offset against future import duties. Recent changes have also been taken to ease the administrative demands of the scheme, such as relaxing the need for ministerial approval, government gazettal of every refund, and reduced paper work and supervision of exports (Customs Regulations). Proposals were again announced in the 1999 Budget to offer exporters an export duty credit on import duties.

82. However, the tariff reforms from 1 July 1999 have eliminated virtually all tariffs on imported inputs, thereby removing the need for a duty drawback system. Although exporters are still penalized

⁹ New products for which import parity pricing is prevented due to tariff are ineligible.

by the tariff regime, for example, through the exchange rate and adverse effects on resource-use efficiency, these imposts are not compensated for by any drawback scheme.¹⁰

83. All exports (except logs) are zero-rated for VAT purposes. Thus, VAT is not levied on exports, and exporters can claim a tax credit for VAT paid on inputs. This will reduce the bias against exports. However, exporters are still penalized by excise taxes paid on fuels.

(viii) Export finance and promotion

84. Such schemes do not exist in PNG according to authorities.

(ix) Export-processing zones

85. The government intends to develop free-trade zones into export-processing zones.

(x) Other measures

86. No export cartels exist in Papua New Guinea according to authorities.

(4) INTERNAL MEASURES

(i) Taxation

(a) Indirect taxation

87. As discussed earlier, a key feature of the tax reforms in 1 July 1999 was the introduction of a 10% single-rate VAT on goods and services, subject to limited exemptions such as health and education services. VAT revenue (and excise duties) was used to fund the significant tariff reductions and the removal of provincial sales taxes, in return for provinces sharing in the VAT revenue with the national Government. Provincial sales taxes, previously levied at a general rate of 3% but with higher rates of up to 5% on cigarettes and alcohol, were abolished.¹¹ The VAT on rice is being phased in over three years using a rebate system. A registration threshold of K 100,000 annual turnover exists to simplify tax administration.¹²

88. All exports are zero-rated, except for logging. Logs are exempt from VAT, whether or not exported, but are not entitled to tax credits for VAT paid on inputs. The treatment of mining and petroleum exports is still under consideration following several announcements. The latest proposal, considered in the 1999 Budget, allows for zero-rating of exports, along with full tax credits on inputs, with a new mining tax of 4% of assessable income levied from 1 July 1999. The 4% mining tax is designed to recoup the estimated windfall gains that would otherwise accrue to the mining sector from the tax reforms. The sector claims that the levy is too high and that these arrangements would effectively increase its overall tax burden, partly because a tax credit is no longer given for the

¹⁰ By reducing imports, tariffs raise a country's exchange rate above what it would otherwise be, thereby reducing export returns in domestic currency.

¹¹ Although at relatively low rates, provincial taxes were applied to each transaction, thereby resulting in double and cascading taxation.

¹² Small businesses are to be compensated for VAT paid on inputs with a tax credit for a prescribed share of their purchases. Wholesale purchasers of cocoa, coffee, and copra will receive a deemed input credit of 1% of the value of their purchases.

increased royalty payment of 0.75%, which is instead tax deductible for company tax purposes.¹³ These arrangements are being reviewed by a Tax Taskforce.

89. Providing full tax credits for VAT paid on inputs to mining, petroleum, and logging firms when they were also benefiting from the elimination of tariffs on imported inputs would have given them large windfall gains. The Government therefore was keen to cushion the loss to government revenue. However, subjecting these sectors to different rules will effectively penalize exports. Such discriminatory treatment is inconsistent with the tax reform objective of tax neutrality, which would improve economic efficiency. While tax authorities have indicated this differential treatment will be temporary, no time limits have been set. The additional 4% mining levy is to be reconsidered in the 2000 Budget.

(b) Direct taxation

90. Mining and petroleum companies are subject to higher income taxes than those in other sectors. Large resident mining, petroleum, and gas ventures pay company tax rates of 35%, 50% and 30%, respectively, compared with a non-mining rate of 25%. A dividend withholding tax of 17% also applies to company dividends from mining but not petroleum firms.¹⁴ A special additional profits tax of 35% for mining and 50% for petroleum applies to income exceeding designated rates of return - 20% for mining and 27% for petroleum - after the investment is fully recouped.¹⁵ The tax rate on smaller scale mining projects was reduced from 35% to the general rate of 25% in 1995.

91. Mining income tax is paid in foreign currency directly into the Mineral Resources Stabilization Fund at the Central Bank where it is invested in Treasury Bills until allocated in the national budget. The Fund's estimated balance of K 686 million at end-1998 was down from its peak of K 695 million in December 1997. While its objective is to stabilize government budgets and to sterilize the domestic liquidity effects of mining booms, this was undermined by legislative changes in 1994 to allow these funds to secure commercial offshore loans. The previous Government rejected using these provisions again to secure a foreign commercial loan. The Fund's balances have been allowed to rise despite excessive accumulation of public debt. The 1999 Budget foreshadowed a review of the Fund and its functions.

92. The Government imposes a base royalty rate on mining and petroleum projects of 2% of the f.o.b. value of production, increased from 1.25% in 1996. This royalty is paid to landowners. Logging companies also pay royalties to landowners: these are specific rate royalties that increase with the export price of logs. They range from K 10 per cubic metre on logs with a f.o.b. price of K 90 per cubic metre and below, up to K 23 plus 7.5% for logs above K 200 per cubic metre.

(c) Tax measures

93. The Government has extended financial assistance to industry, often on a discretionary basis, through a range of tax concessions and incentives. These measures assist selective recipients in the same way as direct government outlays, either by reducing their tax payments overall or, as in the

¹³ The sector estimated that the initial proposal to zero-rate petroleum and mining exports but to limit tax credits to three quarters of VAT paid on service inputs would cost K 50 million annually in additional tax. In 1997, a levy-production system was proposed whereby the sector would be granted full tax credits for VAT paid on inputs but would no longer receive a tax credit for increased royalty payments.

¹⁴ This may be reduced to 15% for non-resident shareholders in countries having a double taxation agreement with PNG.

¹⁵ Additional profit taxes have not been paid since the Bougainville Panguna mine was closed in 1989.

case of accelerated depreciation arrangements for income taxes, by deferring tax payments.¹⁶ Tax concessions and incentives erode the tax base, thereby compounding the Government's difficult budgetary position. Most are difficult to justify on economic grounds (Table III.6).

Table III.6
Main fiscal incentives

Type of incentive	Effect of incentive	Assessment according to economic efficiency principles
Rural development incentive		
Income tax exempt for up to the first ten years	Limited use	If a firm cannot make a profit it is generally not likely to be making a worthwhile contribution to the economy; Addressing infrastructure constraints and resolving law & order problems are considered to be far better means of ensuring rural development
Losses are deductible against other income		All losses from genuine business activities should be deductible against any taxable income
Double deduction for export market development costs		
Eligible expenditure includes overseas publicity & advertising, market research, tender preparation, samples, trade fair expenses, overseas sales & office expenses	Rarely used due to lack of publicity	All genuine business expenses should be fully deductible only once unless there are clear externality effects
Pioneer industry scheme		
Tax holiday of five years for investment in new manufacturing activities	Acted as a disincentive for non-pioneer firms to enter the industry where an incumbent firm has pioneer status. Extensive lobbying has been encouraged e.g. logging industry	If a venture cannot earn a taxable profit it is generally unlikely to make a worthwhile contribution to the economy; Discretionary arrangements facilitate wasteful lobbying and possibly corruption
Various depreciation provisions		
Capital assets can be written down faster than otherwise	Common provision	All genuine business expenses should be fully deductible. Full and immediate depreciation or its real equivalent is justified. However, the provision should apply to all genuine business activities, not just to particular sectors. Unlimited carry forward of genuine business losses is justified
Expenditure for agriculture, fisheries exports & dive/tourist boats can be written off in the initial year		
Industrial plant & buildings for storage are eligible for increased depreciation of up to 100% of cost, provided a loss is not created for any one year		

Table III.6 (cont'd)

¹⁶ Deferred tax payments assist recipients by providing them with an interest-free loan. The amount of this assistance, and the cost to the Government, is the value of the interest rate concession.

Type of incentive	Effect of incentive	Assessment according to economic efficiency principles
Training levy All businesses with annual payroll above K 100,000 are subject to a 2% levy on wages	Revenue steadily increasing	A payroll tax is likely to be an efficient tax in PNG since the burden will fall in workers' income rather than investment & job creation. No evidence that the tax is stimulating genuine training
Qualifying expenses incurred in training citizen employees can reduce the levy	Used by companies to reduce levy but unclear whether training is occurring or whether creative accounting is being used to reduce tax liability	
Wage subsidy Firms manufacturing new products receive payment for up to five years	No great awareness and not contributed greatly to additional jobs	Wage subsidy is preferable to tariff protection for particular sectors, but it needs to be assessed in terms of a more comprehensive cost-benefit evaluation
Staff training cost Double deduction for wages of apprentices & 75% of certain training expenditure	More information needed to assess effects	Normally deductions should not exceed the value of expenditure but externalities can justify training incentives
Exemption of certain interest income Interest income on deposits with licensed financial institutions, approved fixed interest securities & approved foreign deposits are exempt from income tax	Considered effective to create incentives to save but there is an important distortion in that the exemption does not apply to Treasury bills	With an income tax system savings are effectively taxed since income is taxed. This justifies certain exemptions for capital income but in principle all capital income should be taxed in the same way

Source: AusAid (1998), "Papua New Guinea: Coping with Shocks and Achieving Broad-Based Economic Development", Australian Agency for International Development, Report prepared by Economic Insights Property Ltd., *International Development Issues*, No. 52, May, Canberra.

94. Tax measures also encourage wasteful lobbying and other rent-seeking behaviour by the private sector, just like tariffs and other forms of import protection. This is especially so when wide discretion exists in their use without clear and objective criteria. Possible misuse for mainly political reasons can heavily distort commercial decisions, thereby undermining competition and market efficiency. For example, the five-year tax holidays provided until recently, under the Pioneer Industries Act, to a "pioneer" firm in an industry, deterred competition from new entrants ineligible for such concessions, and were subject to political influence. By narrowing the tax base, such incentives also discriminate against other taxpayers, who incur higher taxes as a result. These incentives in PNG assisted individual firms often against the national economic interest.

95. The Government terminated the Pioneer Industries Act in January 1999, while "grandfathering" existing incentives. Provision of incentives is to be rationalized under the Investment Promotion Authority using the income tax and customs legislation.

96. Many of these tax measures were granted to encourage foreign direct investment. However, international experience suggests that such incentives are usually costly in revenue forgone and provide only obscure benefits (Box III.4). Foreign investment is usually determined by more important commercial factors, such as the political and economic stability of the host nation, as well as its commercial potential. Evidence also suggests that any investment attracted by these incentives alone is likely to be inefficient and easily withdrawn should the incentives stop. This is hardly the kind of investment needed to provide for long-term development.

Box III.4: Effectiveness of investment incentives

Incentives for investment, notably tax holidays, are used in Papua New Guinea. The main aim of these incentives is to attract foreign direct investment (FDI) and thereby develop local industry oriented towards exports. While it is difficult to judge the extent to which incentives have actually attracted FDI to Papua New Guinea, there are grounds for doubting the effectiveness of such measures, based on evidence from other economies. Moreover, in some instances the use of incentives may even be counterproductive.

In the first place, access to incentives is seldom among the main determinants of business decisions. This has been confirmed repeatedly by business surveys. Proximity to markets, the availability of sufficiently skilled labour at relatively low cost, adequacy of essential infrastructure, and a stable economic and legal environment are usually much more important. Other countries' experience with evaluation of tax and non-tax incentives suggests that the cost of such measures to the Government (in terms of expenditure or tax revenue forgone) may exceed the investment generated. Their high cost is related to the difficulty in identifying incremental investment that would not have been undertaken without the incentive.

Tax cuts for foreign multinational enterprises (MNEs) that are taxed in their home countries purely on a residence basis (that is, they receive a full credit for taxes paid abroad) may have little or no effect on the incentive for those firms to invest in the country offering such relief. Such cuts would provide an effective incentive only insofar as MNEs are in an excess foreign credit position, taxes on repatriated income can be deferred, the MNE's home country exempts foreign-source income from domestic taxes, or "tax sparing" is allowed by double taxation treaties.

To the extent that incentives do stimulate particular types of investment, they may result in a less efficient allocation of national resources than would be the case if the Government remained neutral and refrained from influencing private decisions. Any adverse effect of incentives on resource allocation would manifest itself as lower total factor productivity (TFP). The belief that foreign investment should be assisted because it yields social benefits (externalities) that are not adequately taken into account by private investors, would appear to be overstated. Most benefits of foreign investment accrue privately and hence do not need the incentives. Moreover, it does not provide a justification for assisting foreign over domestic investment and, since it is usually extremely difficult to measure such externalities precisely, there is always the likelihood that incentives will turn out to be excessive.

Incentives are usually expensive for the Government, involving large losses in tax revenues. A tax system embodying many special incentives is also much more susceptible to tax avoidance and evasion, which further contribute to the loss in tax revenues. Incentives therefore tend to worsen the fiscal balance, reducing national savings and causing deterioration in the current account balance.

Lastly, use of investment incentives may provoke countermeasures by trading partners. Even where they do not contravene the WTO Agreement on Subsidies and Countervailing Measures, other countries may use them to justify countermeasures. In particular, countries may react by adopting incentives of their own, thus resulting in a beggar-thy-neighbour situation. Such an "incentives race" or "incentives shopping" tends to be harmful to all countries concerned. It is also likely to disadvantage developing countries.

Rather than offering incentives to attract foreign investment, governments might instead focus on removing existing impediments that deter investment. Countries often have a mix of policies that simultaneously impede and encourage foreign investment. Rationalizing these policies to remove impediments is likely to be the best approach.

In the case of taxation, the most efficient means of removing the specific obstacle to FDI posed by international double taxation of profits earned by foreign companies in Papua New Guinea may be double taxation treaties with the governments of the countries in which foreign investors reside. In this way, MNEs investing in PNG could obtain relief for taxes levied by the PNG Government. At present, PNG is looking to extend the number of double taxation treaties it has with other governments. Development of a tax treaty network would obviate the need for investment incentives, notably tax holidays, and be a more effective means of attracting FDI.

Controlling the prolific use of investment incentives has been the subject of a number of recent discussions, including among OECD Members and in the WTO 1996 Annual Report.

Source: WTO Secretariat.

(ii) Standards and other technical requirements**(a) Standards, testing and certification**

97. Papua New Guinea does not have well developed procedures for setting technical standards. National standards were set since 1993 by the National Institute of Standards and Industrial Technology. The Investment Promotion Authority now administers these functions. The Government aims to align national standards with international norms, especially on food labelling, electrical and electronic appliances, as well as plastic and rubber products. PNG is a member of various international standards bodies, such as the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC). Fish processors, for example, must comply with the new Food Sanitation Act, which meets the standards of the Codex Food Code.

98. There are over 1,400 national standards in PNG. About 50% are based on ISO norms and less than 10% on IEC standards. The rest are mainly Australian and New Zealand standards. Most standards are set for health and safety reasons, on chemical and hazardous fertilizers and herbicides, construction equipment, and building hardware. Environmental standards apply on food, pharmaceuticals, electro-medical equipment, household and industrial chemicals, cosmetics, and beauty products. According to the authorities, these standards are applied to imports and domestically produced goods without distinction.

99. PNG intends to sign mutual recognition arrangements in metrology, food, and toys. It is developing arrangements for national accreditation and certification of bodies to conduct conformity testing. This includes plans to develop a National Certification System of Conformity Testing. No accredited testing institution currently exists. Future accreditation is to be based on ISO guidelines. PNG usually recognizes test results from reputable overseas institutions. However, exports from such suppliers have sometimes been required to undergo PNG testing.

(b) Health, sanitary and phytosanitary regulations

100. The Animal and Plant Disease and Control Acts and the Quarantine Act prohibit imports of animals, plants and their products without an import permit. Applications for import permits must include an original certificate of origin from the manufacturer and the appropriate authority in the exporting country, and be submitted at least six weeks before exportation. If the import is from a non-established trading partner, a permit will be issued only after PNG officers undertake a country veterinary assessment at the expense of the importer. This takes a minimum of 18 months. Imports must comply with the terms and conditions specified in the permit. Once imports are satisfactorily inspected, a Permit to Land is issued.

101. Special conditions apply to imports of certain live animals, mainly cattle, horses, sheep, goats, pigs, birds, dogs, cats, bees, and live fish. These may only be imported from Australia and New Zealand. Special conditions also apply to animal products, some of which cannot be imported from countries other than Australia and New Zealand (Table III.7).

102. Plant and related materials are classified as either prohibited or restricted. Prohibited plants, comprising betelnuts, breadfruit, sugar cane, passionfruit, sweet potatoes, taro, and yams, may only be imported for research purposes by a recognized institution. Imports of Barberry, Indian hemp, cocaine and water hyacinth are prohibited outright. Import restrictions cover a wide range of plants and related materials (Table III.8).

Table III.7
Quarantine restrictions on imports of animal products

Product	Australia	New Zealand	Other countries of origin
Fresh, chilled, frozen meats & smallgoods	Yes	Yes, but not pig meats or small goods containing pig meat	Prohibited, except for beef from Vanuatu
Canned meat and poultry (other than pig meats)	Yes	Yes, but not pig meat	Yes, subject to manufacturer's declaration on heat treatment & veterinary certificate
Canned pig meats, pork & ham	Yes	Yes, as for other countries	Yes from U.S., Canada, Eire, UK, the Netherlands & Denmark, subject to manufacturer's declaration on heat treatment & veterinary certificate. Other countries must be free of certain diseases
Dairy products	Yes	Yes	Yes for liquid milk and cheese, subject to manufacturer's declaration on heat treatment & veterinary certificate
Meat, blood & bone meal	Yes, subject to manufacturer's declaration on heat treatment & veterinary certification	Yes, as for Australia	Prohibited
Honey & other bee products			
- liquid or powdered honey	Yes, subject to manufacturer's declaration on heat treatment & veterinary certification	Yes, as for Australia	Prohibited
- liquid royal jelly	Prohibited	Prohibited	Prohibited
- beeswax & used bee-keeping equipment	Prohibited	Prohibited	Prohibited
Miscellaneous foodstuffs			
- eggs	Yes	Yes	Yes, as a component of canned foodstuffs, subject to manufacturer's declaration on heat treatment & veterinary certification. Prohibited in all other forms
- noodles	Yes, for both plain & egg noodles	Yes, as for Australia	Egg noodles prohibited. Plain noodles allowed subject to manufacturer's declaration of no egg content, endorsed by a government veterinary officer
- pet food	As for canned or processed foodstuffs	As for canned or processed foodstuffs	As for canned or processed foodstuffs
- margarine	Yes	Yes	Yes, subject to manufacturer's declaration that it contains no animal material but only vegetable or fish oils
- canned seafood	Yes	Yes	Yes

Source: The authorities of Papua New Guinea.

103. Imports of all vegetables (except onions), and fruit that can be grown in PNG are banned. Fruit not available in PNG is subject to an "on-quota" list and requires an import permit (Table III.9). Onions may only be imported by a holder of a fruit import permit.

104. According to PNG authorities, quarantine regulations have been based on risk assessment taking into account the relevant health status of the country of origin.

Table III.8
Restricted imports due to plant quarantine

Avocado	Fruit & vegetables – fresh, frozen, dried, canned or bottled	Opium poppy	Sago
Bamboo	Ginger	Orchids	Seeds
Banana	Grape	Packing materials	Soil
Bromeliads	Grass e.g. Lucerne	Palms	Soybean
Bulbs & tubers	Grass seed	Pawpaw	Strawberry
Cacti	Kapok	Peanuts	Sunflower
Cereals	Legumes	Peat	Tapioca
Citrus	Maize	Pepper	Tea
Cloves	Mango	Pineapple	Timber
Coconut	Mushroom	Potato	Tobacco
Coffee	Nursery stock	Pyrethrum	Tomato
Flowers	Oil palm	Rice	
Forest tree species	Onion, garlic	Rubber	

Source: The authorities of Papua New Guinea.

Table III.9
Quarantine bans and restrictions on imports of fruit and vegetables

Quarantine bans and restrictions on imports of fruit and vegetables				
		Fruit	Vegetables	
Banned		Not banned	Banned	On quota
Artichoke	Lettuce	Onions, but a permit is required to import fruit	Avocados	Apples
Asparagus	All melons		Bananas	Apricots
Beans	Okra		Breadfruit	Blackberries
Beetroot	Marrow		Custard apples	Blueberries
Broccoli	Parsley		Guavas	Cherries
Brussels sprouts	Parsnips		Lemons	Figs
Cabbage	Peas		Limes	Gooseberries
Capsicum	Potatoes		Mangoes	Kiwi fruit
Carrots	Pumpkin		Pawpaws	Lychees
Cauliflower	Radish		Passionfruit	Mandarins
Celery	Rhubarb		Pineapples	Nectarines
Chicory	Silverbeet		Pamelos	Oranges
Corn	Spring onions		Strawberries	Peaches
Cucumbers	Squash			Pears
Eggplant	Shallots			Persimmons
Endive	Swedes			Plums
Fennel	Sweet potato			Pomegranates
Garlic	Tomatoes			Raspberries
Ginger	Turnip			Tangelos
Leeks	Zucchini			Any other fruit not available in PNG

Source: The authorities of Papua New Guinea.

(iii) Direct assistance

(a) Input and transport subsidies

105. Most agricultural inputs are unsubsidized. They are either privately traded, as for fertilizers, chemicals, seeds, and breeding stock or, as in the case of planting materials for major export crops, provided by government agencies at full cost recovery.

106. However, several government subsidies have existed since May 1992. The Government subsidizes coffee pulpers, cocoa-fermenting vats, farm tools and sundry other equipment used by smallholders. These are intended to compensate for low commodity prices, and to improve product quality and husbandry practices.

107. Freight subsidies to compensate for the high transportation and handling costs are provided for cash and high value crops, such as cardamom and vanilla, marketed from remote areas in East Sepik, Simbu and New Ireland provinces. A freight subsidy for breeding stock transported into these regions is aimed at promoting genetic improvements. In addition, transport subsidies apply to seedlings and fertilizers used by smallholder for oil palm cultivation. Cocoa and coconut seedlings are distributed free to farmers in the provinces of East New Britain and North Solomons as a form of disaster relief.

108. The cost to the Government of these subsidies is unknown, but thought to be relatively small. However, these inputs may have significantly distorted the incentives for growing tree crops when combined with other assistance from price support measures.

(b) Assistance to research and development

109. The Government provides limited direct funding to agricultural research and development. Agricultural research is funded by the Department of Agriculture and Livestock, on average amounting to K 9-10 million annually or less than 1% of agricultural GDP. Such research is concentrated more on the four major export crops (coffee, copra, cocoa, and oil palm) than on smallholder food crops and livestock.¹⁷ In 1997, the Government established the National Agricultural Research Institute, a publicly funded statutory authority, to focus on applied food crop and livestock research targeting smallholder semi-subsistence farmers. After an initial government grant of K 6 million it has operated from private funding.

110. Government support is also provided to a number of publicly and privately owned commodity-specific research institutes, such as the Cocoa and Copra Research Institute, the Oil Palm Research Association and the Coffee Research Institute (now part of the Coffee Industry Corporation). These activities are also funded by export levies (representing from 55% to 90% of funding over 1990-93).

111. The Forest Research Institute was established in 1989 to conduct research on sustainable management of forests.

112. The responsibility for providing extension services to farmers now rests with the provincial governments. However, most extension services are provided privately by industry institutions as part of their research activities.

¹⁷ World Bank (1997). Agriculture research on tree crops has accounted for about 2% of tree crop GDP, compared with 0.4% of GDP for livestock, food and other minor crops.

(c) Concessional loans and credit

113. Credit availability is a major constraint in PNG, especially in rural areas. The Government has tackled this problem through directed lending programmes to government-owned banks, and by subsidizing credit through various schemes. Two public banks were involved, the PNG Banking Corporation and the Rural Development Bank; the two were recently merged. The Corporation provided about three quarters of agricultural credit supplied by commercial banks, while just over half of loans from the Rural Development Bank went to agriculture. The Government has traditionally used these institutions, and the financial system generally, as a means of delivering concessional rural credit to promote rural development.

114. The Credit Guarantee Scheme required the Rural Development Bank to direct subsidized credit by way of unsecured mini (K 500-K 2,000) and small (K 2,000-K 10,000) loans for rural based activities using informal collateral. This scheme suffered from substantial bad debts and repayment arrears by borrowers. The Government also directed the PNG Banking Corporation and commercial banks to provide concessional agricultural loans with little regard to collateral or credit risk appraisal. As a result, rural funds have generally been inadequate, and the state-owned banks in particular have a high share of non-performing rural loans. The Rural Development Bank, for example, performed unprofitably, and was insolvent by K 9.3 million in 1994, with debts subsequently written off by the Government. Private banks also see agricultural lending as high risk and unprofitable, due partly to government-administered concessional loans and government-initiated moratoriums on repayments.

115. The Department of Agriculture and Livestock commenced the Smallholder Agricultural Credit Scheme in 1996, involving also the Rural Development Bank, to provide credit for smallholder projects.

116. The Government also operates a Credit Guarantee Loan Scheme involving the PNG Banking Corporation and all commercial banks. The Government guarantees the banks 80% of the debt outstanding at any time, and also provides a subsidy. The Small Business Development Corporation has operated a Small Business Guarantee Facility, since 1996, which guarantees loans to eligible small businesses from participating commercial banks. However, to date only two commercial banks have participated in the scheme, involving only a few firms. The Bank of Papua New Guinea administers a similar scheme providing subsidized loan and equity financing for small businesses; it is funded by the European Investment Bank, again with reluctant participation from commercial banks.

117. International experience suggests that provision of subsidies is often destructive to the lending institution and can in the longer term reduce the supply of credit to targeted groups. Subsidized credit schemes are usually difficult to justify on either economic efficiency or equity grounds. Such loans distort the efficient operation of financial markets and generally accrue to large better-off producers. Moreover, the provision of subsidized loans from state-owned banks is likely to crowd out more efficient private suppliers of credit. Quite paradoxically, removing credit concessions would probably expand rural lending and reduce interest rates to targeted groups.¹⁸

118. Rural lending is also adversely affected by the communal land tenure system in Papua New Guinea. The absence of clear title to land seriously reduces the value of land for loan collateral purposes. This makes banks more reluctant to lend, or to require a higher interest rate to cover the risk premium. The link between land tenure and access to credit is critical. Although some measures have been implemented to overcome this problem, such as the use of Clan Land Usage Agreements, it remains a major obstacle to providing credit. In addition, law and order problems are

¹⁸ Jarrett and Anderson, 1989.

limiting access to credit in rural areas: they have increased the costs of banks doing business in rural areas and contributed to the closure of branches in small villages. Lack of land tenure is also a major disincentive to foreign investment in agriculture, thereby further reducing agricultural land values and discouraging investment in land improvement.

(iv) Restrictions on foreign investment

119. Under the Regulations of the Investment Promotion Act 1992, investment in many business activities is reserved to PNG citizens and national enterprises (enterprises with foreign participation but majority domestic ownership). These activities are closed to foreign enterprises that are 50% or more owned or controlled overseas. Most reserved activities are also closed to national enterprises and open only to PNG citizens. These include certain small-scale agricultural activities, coastal fishing, real estate, equipment rental services, small hotels and restaurants, coastal and land transportation, and motor vehicle repair, as well as a range of wholesale and retail services (Table III.10). Reserved activities that are closed both to foreign and PNG citizens and open only to national enterprises include fish hatcheries and farming; certain tourist related activities; alluvial mining; and coastal freight transportation. The reserved list of activities is currently under review.

Table III.10
Activities closed to foreign investment

Category	Activity
A. Citizen enterprises	
Agriculture	Small-scale growing, processing and development for export of tree crops (coffee, cocoa, copra, tea), crops, as well as market gardening and horticulture, animals and mixed farming; poultry farming; and hunting, trapping and game propagation.
Forestry and logging	Small-scale and walk-about sawmilling; gathering of wild growing forest materials, e.g. rattan, herbs, wild fruits and flowers.
Fishing	Commercial coastal (within three miles) and inland fishing; collecting of crustaceans, molluscs, natural pearls and sponges.
Wildlife	Hunting and collection of non-protected fauna.
Business	Land surveying and valuing; post couriers; installation and servicing telephones, etc; sign writing; labour recruitment; contract cleaning; and immigration services.
Health and social work	Child-care activities.
Mining	Small-scale gold buying.
Real estate	All forms.
Rental machinery	Land transport equipment, e.g. cars, vending and amusement machines, TVs, videos, and sound equipment.
Recreational and cultural	Indigenous culture and art; and motion picture distribution and projection.
Recycling	Car parts, drums, bottles, and scrap metals.
Hotels, etc.	Fast food outlets; and places offering short-term lodging with less than ten rooms.
Transport	Customs clearances forwarding services; land, coastal, and inland water transportation of freight and people; and certain airport services, e.g. building and maintenance.
Security services	Security guards and dogs.
Car sales and repair	Wholesale, retail and repair of second-hand cars and bikes; retail sale of fuel.
Wholesale and retail trade	Crocodile skins; coffee and copra; handicrafts; wild growing forest materials; food, beverages, and tobacco; textiles, clothing, and footwear; and other household goods from outlets below 500 sq. metres; newspapers and magazines; stalls and markets; repair of electrical household appliances; shoe repair; and watch repair.
B. National enterprises	
Fisheries	Fish hatcheries and farming.
Hospitality	Tourist-related activities, e.g. village guest houses; travel agencies and tour operators.
Transport	Coastal transportation of bulk goods; and hiring of sea transport equipment.
Security	Security systems, armoured fleets etc.

Source: PNG Investment Promotion Authority.

(v) Protection of intellectual property

120. Papua New Guinea has little legislation to protect intellectual property rights. The Trademarks Act, passed in 1980, established a register of trade marks, which is maintained by the Office of the Registrar of Trade Marks located in the Investment Promotion Authority. There are currently 12,400 registered trade marks in PNG. The Copyright Act of 1978 was never implemented.

121. There is little or no enforcement of intellectual property rights. Producers or importers may use the common law remedies available in domestic courts under Part XI of the Trademarks Act to protect against counterfeits or infringements of trade marks. The same applies to copyright.

122. There are no provisions in the Customs Act for the seizure of imported goods that infringe intellectual property rights. No provisions exist in the trade marks or copyright legislation to allow for seizure by customs of imported pirated or counterfeit goods. Such goods do not constitute prohibited imports under customs legislation. The only possibility would be for the Commissioner of Customs to invoke his general discretionary power to declare such goods as unauthorized imports. However, this has never been used against pirated or counterfeit goods.

123. The Government intends to adopt the necessary legislation on intellectual property by 2000, but would appear to need technical assistance to do so. The Intellectual Property Office has been established to administer new legislation to be introduced shortly on copyright, and on patents, industrial designs, and trade marks. This legislation has been prepared in conjunction with the World Intellectual Property Organization (WIPO), to which PNG acceded in 1997. PNG is a signatory of the Paris Convention (1967) but not of the Berne Convention, the Rome Convention, or the Treaty on Intellectual Property in Respect of Integrated Circuits.

(vi) Government procurement

124. Papua New Guinea is not a member of, nor an observer to, the WTO Plurilateral Agreement on Government Procurement. It does not intend to become a signatory to this Agreement until multilateral disciplines covering procurement are developed.

125. According to the authorities, Papua New Guinea has a liberal and decentralized public sector procurement system for goods and services. This is believed to encourage open tenders without discriminating between local and foreign suppliers. The Central Tenders Board must approve public procurement of goods and services over K 500,000. Below this ceiling, government preferences are provided to national companies on construction contracts.

(vii) Corporatization and privatization

126. State-owned public enterprises and statutory authorities occupy a prominent position in Papua New Guinea, and have traditionally been formed under separate legislation. They do not operate under the Companies Act. They are controlled by a board of directors headed by the managing director, generally appointed by the Cabinet or relevant minister. They are funded to varying degrees by government transfers and loans. While authorities may borrow with Finance approval, loans are usually channelled through the national Government.

127. Statutory financial institutions, such as the Public Officers' Superannuation Fund, the National Provident Fund, the Investment Corporation of PNG and the PNG Banking Corporation, generate their own returns and in principle operate for profit, as do other commercial statutory authorities. These include the utility providers, such as the PNG Electricity Commission and PNG Telikom, as well as Air Niugini. Other statutory authorities, such as the National Broadcasting

Commission and the National Fisheries Authority, depend for all or part of their funding on government transfers. Such transfers have generally accounted for between 10% and 15% of government expenditure, or 1% to 2% of GDP.

128. Statutory authorities are now required to meet minimum performance targets of an economic rate of return of 10% and a minimum 16-22% financial rate of return. Commercial statutory authorities must also pay dividends to the Government equal to 50% of after-tax profits, unless they have exceptional capital needs. Their operations are heavily influenced by government controls. These include approval by the Finance Minister of all contracts over K 0.5 million; price controls on a number of their services; and approval by Cabinet of five-year rolling corporate plans.

129. Governments have repeatedly supported the commercialization and privatization of statutory authorities. However, most announced plans have not been implemented. The PNG Holdings Corporation was formed in 1992 to implement a privatization programme, but little eventuated. Previously announced plans to privatize major commercial statutory authorities, including Telikom PNG, Air Niugini, Post PNG, PNG Banking Corporation Group, Eda Ranu, PNG Harbours Board, and the PNG Electricity Commission have proceeded slowly. In 1996 Air Niugini and Post PNG were corporatized. In 1998, the Government also amalgamated the Motor Vehicle Insurance Trust, the Niugini Insurance Corporation and the Rural Development Bank for sale to the PNG Banking Corporation. A number of the Government's interests in the agriculture and mining sectors have also been divested. New Guinea Forests Products was sold in 1996 and the Government's preference shares in Ramu Sugar were sold in 1995. Shares in West New Britain Palm Oil and Hargy Oil were also partially sold in 1996. In 1996, the Government also floated on the Australian stock exchange, under the name of Orogen Minerals, 49% of its interest in several gold and petroleum projects (Kutubu, Gobe, Lihir and Misima) previously held by the Mineral Resources Development Corporation - the statutory authority holding the Government's shares in mining and petroleum ventures.

130. The previous Government had reaffirmed its commitment to privatization as a key part of the structural reform programme by including in its 1999 Budget a comprehensive privatization programme. Privatization proceeds were to be used to fund the budgetary cost of public sector reform and to reduce public debt. Initial priorities included the sale of government stores, offices, and vehicles (through the sale of the Public Transport Board) and plantations, as well as the privatization of the PNG Banking Corporation, Telikom and the Government's equity in mining companies.

131. In its 1999 Economic Recovery Programme, the previous Government reiterated its intention to complete the 1999 privatization programme (Table III.11). This was expected to raise some K 60-70 million, and was to be implemented by the Privatization Council, with support from the Office of Public Enterprises and Assets Management.

132. More recently, the incoming Government has indicated that it would implement a radical privatization programme aimed at raising between K 3 and 5 billion to help reduce public domestic debt. This would include the privatization of Air Niugini, Telikom, Post PNG, PNG Harbours Board, Halla Cement, Ramu Sugar, the PNG Electricity Commission, Government Stores and Supplies, PNG Banking Corporation, and Niugini Insurance Corporation. Individual departments and ministers would no longer be involved in the disposal of state assets. Instead, a Privatization Commission of PNG would be established under the Ministry of Corporatization and Privatization.

Table III.11
Privatization and divestiture timetable

Public enterprise	Govt. share (%)	Latest value of holding	Privatization type	Deadline	Status	Further action
PNG-Halla Cement Ltd	50	Value is nil. Gov. has guaranteed US\$11.5 million of loan from Korean Eximbank	Direct negotiation with international cement companies	31.07.99	Negotiation under way with two firms	Encourage potential buyers: allow firm to use own wharf; apply anti-dumping laws against unfair competition
Public Transport Board	100	K 40 million	Sale of lands, vehicles & equipment by tender or auction	Start by 30.09.99		Value assets
Air Niugini	100	K 12 million based on assets, but goodwill yet to be valued	Mangt-peform. contract for two years, then privatize	30.10.99	Draft report on firm's operation with Government	Prepare draft management performance contract & invite bids
Telikom PNG Ltd	100	K 1,150 million (1996 profit of K 24.3 million)	By international bidding	Feb. 2000		Prepare profile; appoint investment bank through competitive bidding to prepare bidding documents & advise on necessary action to privatize; set up regulatory authority
Llimo Poultry Products (five subsidiaries)	100 ^a	K 10 million against K 16 million debt	Liquidate Llimo; tendering for all assets (if possible); otherwise direct negotiation	31.07.99		Value net assets; prepare sale documents; advertise sale in papers;
Stenin bay Lumber Company	8.3		Sale of shares to private partners through negotiation	31.07.99	Private shareholders willing to negotiate purchase of Govt's. shares	Value assets; negotiate sale
Printing Office	100		Sell building by tender; auction other assets	31.08.99		Determine ownership of land; value assets; keep equipment needed to publish sensitive govt. documents
Hargy Oil Palms Pty Ltd	50		Sell share to private partner			Value net assets; negotiate sale with private partner
Open Bay Timber Pty Ltd	20	K 3.9 million (net assets 1997)	Sell share to private partner			Value assets; negotiate sale with private partner
Overseas real estate assets	100	US\$9.7 million	Sale of buildings and vehicles	30.09.99	Sold due to closure of diplomatic missions	Appoint reputable agents to supervise sale

a Investment Corporation.

Source: Government of Papua New Guinea (1999), *Economic Recovery Programme*, June.

133. Many public enterprises continue to incur losses, partly a result of government pricing policies requiring them to meet social objectives, including maintaining uniform prices. Elcom, Telikom and Air Niugini currently make large losses, and are heavily indebted. The previous Government injected K 50 million to re-capitalize Air Niugini and reduce the PNG Banking Corporation's debt exposure to the airline. The Corporation advanced these funds to the Government as part of the restructuring and purchase of the Motor Vehicle Insurance Trust. This restructuring was

apparently fast-tracked to raise government revenue with little transparency and consultation with the Treasury or the Central Bank, and with no proper valuation of the Trust's assets. Such quasi-fiscal transactions cloud the financial affairs of Government and statutory corporations.

134. The poor financial performance of most public enterprises is mainly symptomatic of poor management and operating inefficiencies. Some ventures appear from the outset to have been commercially questionable. Most utilities are supplied to captive markets by state monopolies devoid of competition. Relatively high prices and poor quality of key services, such as electricity and telecommunications, inhibit growth and investment in Papua New Guinea, and inflate business costs considerably. Access to quality utility services at competitive prices would improve the international competitiveness of user industries, and would encourage foreign investment.

135. Decisions on which entities to privatize or divest need to be based on making key service markets more competitive and efficient rather than on revenue considerations. Private operation of utilities can take several forms (Box III.5). The key to improving efficiency is not so much changing ownership, but more importantly removing statutory barriers to new entrants and investment, including foreign participation.

Box III.5: Private-sector participation in public utilities

Increased private-sector participation is likely to bring most efficiency benefits when it is accompanied by efforts to make the market more competitive.

A number of different types of arrangements may be used to increase private-sector participation in public utilities:

Service contract: the private firm supplies specific services, e.g. meter reading;

Management contract: the private firm takes over operation and maintenance of the utility, and makes day-to-day management decisions;

Lease contract: the private firm leases facilities and operates and manages the utility, including financing of working capital and replacement of assets;

Concession arrangement - build, operate and transfer (BOT): the private firm acquires ownership of assets and completely runs the utility for a certain period, e.g. 20 years, and then transfers the utility back to the public authority;

Divestiture/privatization: the private firm takes complete control of the utility by purchasing assets. Such firms may be subject to specific regulatory controls on pricing behaviour, or fall under general anti-competitive legislation that prohibits non-competitive pricing.

Privatization of essential services, such as electricity and water, in a relatively small economy may raise legitimate concerns that a single private supplier may charge consumers monopoly prices that are non-traded. The small domestic market in PNG may be sufficient to support only one supplier, especially where significant economies of scale and scope exist: the so-called case of a natural monopoly. However, these real concerns do not necessarily justify public provision. Many utility services may be provided efficiently through commercial presence of foreign investors, combined with effective government regulation. The benefits from privatization would be substantially increased if legislative barriers to foreign investment were repealed.

Source: Asian Development Bank (1997b), "Vanuatu Case-Study", *Water Supply and Sanitation Study Tour*, South Pacific Regional Office, Port Vila.

(viii) Competition and related policies

136. There is no national competition policy or specific competition legislation in Papua New Guinea. The only laws protecting consumers from unfair trade practices are the Consumer Protection Act and the Price Control Act. The Government intends, over the longer term, to introduce a business practices act and a national competition policy.

(a) Price controls

137. The Government controls the prices of a range of goods and services, mainly key agricultural products, such as flour, rice, dairy products, and canned fish, as well as utility services, shipping freight rates, and internal air fares. These are important items of final consumption, and currently cover some 30% of the basket of goods and services used to construct the consumer price index. There are three methods of price control under the Price Regulation Act: maximum prices for some services and certain items, such as foodstuffs and concrete, are set directly; for other goods maximum mark-ups are determined; fuel prices are subject to a ceiling linked to import parity, and reviewed monthly.

138. The Finance Secretary sets prices and mark-ups. Submissions on price changes are received from suppliers, usually annually.¹⁹ The Consumer Affairs Council is responsible for administering and enforcing the price controls. However, sanctions are limited to written warnings; legal remedies are not available due to lack of resources.

139. Price control measures are seen by authorities to strike a balance between consumer and business interests in markets where prices may otherwise be too high, due to low competition, insufficient information, shortages, or protected businesses. The Government has moved away from price regulation and controls, believing that these distort markets. Coverage of price controls was reduced in mid-1995 when they were lifted from items accounting for some 16% of the CPI basket, including on bakeries, breweries, and soft drinks. Plans exist to de-control prices on other goods and services representing another 21% of the basket; when implemented, price controls would remain on about 9% of items included in the CPI basket.

(b) Agricultural marketing arrangements

140. The Government has been actively involved in the marketing and pricing of traditional key cash crops, which that are mainly exported. Marketing boards in PNG have been replaced by private industry corporations responsible for marketing, extension, and research. An exception is the government-owned statutory trading company, the Copra Marketing Board. It exclusively markets domestic and export sales of copra and coconut products. The Board buys virtually all copra and allocates sales between exports and the sole domestic copra oil producer Coconut Products Limited.

141. Domestic and export sales of coffee, cocoa, and oil palm are marketed privately by the Coffee Industry Corporation, the Cocoa Board, and the Oil Palm Industry Corporation. Although these boards do not trade directly in these products, all dealers, traders, processors, and exporters of these commodities must be licensed with the respective body. Coffee, for example, is marketed abroad by 19 registered exporters, produced by 51 factories and purchased by over 6,000 roadside buyers, while cocoa has ten exporters, 1,400 fermentaries and almost 1,000 wet-bean dealers. Such trade licensing does not appear to have inhibited competition nor led to inefficient operators in PNG. Evidence

¹⁹ Authority for setting prices was transferred to the Consumer Affairs Council in May 1996 but was subsequently returned to the Finance Secretary. The National Land Transportation Board is the price-setting agency for selected transportation services.

suggests that coffee and cocoa growers receive competitive prices, ranging between 70-80% of the f.o.b price. Marketing margins used by these bodies reflect international marketing, transportation, and processing costs.

142. Price schemes are a traditional feature of export crops. Price stabilization schemes were introduced for copra in 1946, coffee in 1966, cocoa in 1974, and oil palm in 1983. These schemes were designed to stabilize prices by imposing levies on or paying bounties to growers when commodity export prices rose above or fell below formula-set trigger prices. While the schemes were largely self-financing during most of the 1980s, funds became exhausted during the late 1980s following prolonged periods of depressed prices. Public loans became necessary to finance the schemes.²⁰ These were replaced by what have been price support schemes, in November 1992, under a five-year arrangement that set trigger prices at relatively generous levels. Substantial bounties were paid to growers to support export prices that were below the trigger price. Budgetary assistance (exclusive of STABEX assistance) through this support rose from K 56 million in 1992 to K 98 million in 1993, before declining to K 41 million in 1994. These schemes contributed to the Government's fiscal crisis at the time.

143. Although price support subsequently ceased for these four commodities and, except for cocoa, growers were charged levies as domestic prices rose (boosted in kina terms by the currency devaluations) to partly repay the price support loans, the cumulative fiscal burden remained substantial. As of mid-1997, loans of K 118 million, or some 2% of GDP, remained outstanding, mainly owed by the Coffee Industry Corporation. The levies currently paid by coffee and copra growers are set at 65% of the excess of export prices over the domestic trigger or support price plus a 10% margin. The Corporation uses half of these collections to repay public debt; the balance accrues to the stabilization fund.

144. Trigger or support prices for coffee, cocoa, and copra were raised by 25% in March 1998. This benefited growers by reducing the levy paid to the Government, by as much as K 30 million, while also committing the Government to larger payouts should export prices fall below trigger levels. According to the authorities, these schemes were terminated in February 1999 when all loans were repaid. A price support scheme continues to be run by the Coffee Industry Corporation without government involvement.

145. Price stabilization schemes, especially de facto support schemes that are not self-financing, are difficult to justify on economic efficiency grounds. By assisting agriculture, they distort resource use by favouring certain agricultural activities over others, and relative to non-agricultural activities. Even if self-financing, such schemes can be detrimental to grower's welfare and economic efficiency by suppressing the transfer of price signals back to them. For example, they would have muffled the beneficial effects of currency devaluations on growers' export returns. This can affect supply responses, by encouraging growers to produce less when world prices are high, and more when world prices are depressed. This, in turn, may accentuate price instability. They are poor macro-stabilization devices, and have dampened investment in PNG agriculture²¹; they are also inequitable

²⁰ Although the loans were granted by commercial banks, the Government collateralized the loans by providing deposits with the Central Bank using STABEX funds, initially as loans, but converted to grants in 1991.

²¹ Jarrett and Anderson, 1989.

between growers and over time, and are an ineffective means of targeting welfare assistance to farmers.²²

146. Exclusive trading and agro-processing rights are also enjoyed by some other entities. The wholly government-owned Livestock Development Corporation has sole rights over the construction and management of abattoirs. This has precluded private entrants, and may have inhibited meat processing. The Corporation is also responsible for managing government livestock activities, such as ranches, piggeries and poultry hatcheries. Its profitability depends heavily on free access to public assets without being required to pay dividends to the Government. The Lae mackerel plant has exclusive rights over mackerel canning.

147. Direct foreign participation in agricultural marketing and trading is prohibited.

²² These schemes during the 1970s and 1980s benefited mainly the bigger, more prosperous, largeholders at the expense of the smallholders. They were also inequitable over time since the growers who paid the levies were often no longer in existence when bounties were paid during depressed international prices.