

EXECUTIVE SUMMARY

Papua New Guinea is a largely agrarian based society whose economy is increasingly dominated by the exploitation of mineral deposits such as copper and gold. The country is on the verge of a major windfall as foreign oil companies begin the commercialization of large natural gas deposits. The revenue from natural gas has the potential to significantly boost the standard of living of one of the poorest countries in the world. Poverty is widespread with 35.8% of the population living on less than \$1.25 a day and the infrastructure is inadequate as is the education and public health care systems. Much of the workforce is employed in agriculture, which is largely subsistence in nature. In November, the government announced it is considering establishing a Sovereign Wealth Fund to manage its revenues from natural gas.

Geography

Papua New Guinea is a country situated in Oceania with a tropical climate that is slightly larger than California. The rainy season is from December and March. It comprises the eastern half of the island of New Guinea (the second largest island in the world after Greenland) and 600 offshore islands. The largest of these islands is New Britain, which is about the size of Delaware and Maryland combined. Papua New Guinea shares the island of New Guinea with the Indonesian province of Irian Jaya. The population is 6,064,515 and the population density is 13.4 people per square km. Port Moresby, is the capital, the commercial center and the largest city. It has a population of 299,000. The largest port is at Lae. It is located 189 miles northwest of the capital and has a population of 120,000.



Arable land accounts for 0.49% of the area of the country, 12.5% of the population lives in urban areas, there are 5,152 km of coastline, 65.0% of the country is covered by forests and 1.4% of the land is devoted to permanent crops. The median age is 21.7 years, the birth rate is 27.57 per 1,000 people, the death rate is 6.67 per 1,000 people, the fertility rate is 3.62 children per female, 36.9% of the population is under 15 years old, 27.7% is between 25 and 44 and 3.5% are 65 years and older. The population growth rate is 2.17% (UN estimate for 2010-2015). The time zone is ten hours ahead of Greenwich meantime. There are 830 spoken languages. English, Tok Pisin and Motu are the official languages. Tok Pisin is the most spoken language and is the language that much of the debate in Parliament is conducted in. English is the language of government and education but is not spoken widely. Motu is spoken in the south of the country. Papua New Guinea is a former Australian Administrated UN Trusteeship that received its independence on September 16, 1975.

SECTION SUMMARY AND TREND

Political Environment - Government & Civil Liberties	Trend
<p>There is a plethora of political parties that make it difficult to form a stable government. The 2002-2007 government of Prime Minister Somare was the first one since independence to serve a full term. The last legislative elections in 2007 were deemed to be free and fair. Freedoms of religion, speech, press, association and academic freedom are respected. The judiciary is independent but is undermined by a lack of resources and long trial delays.</p>	Stable
Economic Overview	Trend
<p>Infrastructure The road system is in poor condition. There is no railway network. The port of Lae is being upgraded. In rural areas, just 20% of the population has access to clean drinking water.</p>	Negative
<p>Energy Sector Oil production has declined significantly in recent years. However, there are abundant deposits of natural gas that are being developed and which will make Papua New Guinea a major exporter of LNG.</p>	Positive
<p>External Accounts The trade surplus declined markedly in 2009 in response to lower prices for oil and copper, which are among the two principle exports. As a result of the sharp drop in the trade surplus, the current account registered its first deficit since 2002. With the global economy rebounding, the current account should return to surplus this year.</p>	Stable
<p>External Debt The government has used the recent string of current account surpluses to pare down the external debt. The external debt burden is manageable.</p>	Positive
<p>Agriculture Sector Much of agriculture is subsistence or semi-subsistence in nature. Agricultural productivity is low because of a poor irrigation infrastructure, inadequate investment, small farm size, lack of modern farming techniques and equipment, inadequate electricity, a lack of access to credit and poor rural roads.</p>	Negative
<p>Informal Economy More than 80% of the population relies on subsistence farming or the informal economy for their livelihood.</p>	Negative
Business Environment	Trend
<p>Openness to Foreign Investment The government encourages foreign investment to spur economic growth, exports and employment. Foreigners can own 100% of a domestic company and can repatriate their earnings.</p>	Stable
<p>Financial Sector There is a small and shallow banking system that is mainly concentrated in urban areas. There are just 4 commercial banks. The banking system is liquid and non-performing loans are not a major problem.</p>	Stable
<p>Corruption Papua New Guinea is ranked 154 of 180 nations in Transparency International's 2009 corruption perception index. There are laws that provide for penalties for official corruption but they are not effectively enforced. According to the US Department of State Human Rights Report, "Corruption at all levels of government is a serious problem."</p>	Negative

Human Capital	Trend
Papua New Guinea is ranked 148 of 182 in the 2009 UNDP HDI. Poverty is widespread, the life expectancy is 66.0 years, the infant mortality rate is 44.6 per 1,000 live births, the adult literacy rate is 57.8%, the per capita income is \$1.294 (IMF estimate for 2009), and 57.4% of the population lives on less than \$2 a day.	Negative
Economic Outlook	Trend
Papua New Guinea is on the verge of a tremendous windfall when the LNG facilities that are being constructed are completed in 3-6 years. One of the LNG projects is expected to contribute 3.0% of the expected 8.5% growth rate in 2010.	Positive

I. Political Environment

Index	Rank	Score
Freedom House Index 2010	Status: Partly Free	Political Rights: 4.0/7.0 Civil Rights: 3.0/7.0
Bertelsmann Transformation Index 2010	58/128	5.85/10.00
Fund for Peace - Failed State Index 2009	61/177	84.1/120.0
World Bank Gov Indicator 2009, Political Stability	27.3 Percentile	-0.55

1. Government

The chief of state is Queen Elizabeth II who has been represented since June 29, 2004 by Governor General Sir Paulias Matane. The head of the government is Prime Minister Sir Michael Somare. He has held the office since August 2, 2002. Cabinet members are appointed by the Governor General on the recommendation of the prime minister. The Governor General is nominated by parliament and appointed by Queen Elizabeth II. The Prime Minister is the leader of the majority party or the head of the coalition that forms the government.

There is a unicameral National Parliament that has 109 seats. Members are elected by popular vote to a 5-year term. The last election was held between June 30 and July 10, July 2007 and the next election will be in 2012. There are a plethora of political parties that makes for unstable governments as political affiliations are fluid. The 2002-2007 government of Prime Minister Somare was the first one since independence to serve a full term. The National Alliance Party headed by Prime Minister Somare has 27 seats, there are 19 independents and the Papua New Guinea Party has 8 seats. With respect to the fairness of the 2007 elections, The New Zealand Ministry of Foreign Affairs and Trade country profile for Papua New Guinea noted that "Despite some continuing procedural irregularities and an inaccurate common roll, there were relatively low levels of election-related violence (a marked improvement from the previous election in 2002) and election results were generally accepted as valid."

2. Civil Liberties

Freedom House has designated Papua New Guinea as "partly free" and has assigned it a rating of 4 out of 7 for political rights and 3 out of 7 for civil rights. The lower the rating the higher the degree of political and civil liberties. Papua New Guinea is ranked 58 of 128 nations in the Bertelsmann Transformation Index. It is ranked 61 of 177 in the Fund for Peace Failed State Index (the lower the ranking the higher the degree of economic and political dysfunction) and is ranked at the 27.3 Percentile in the World Bank's Political Stability Governance Indicator.

Freedom of speech is respected. The media provides independent coverage and reporting on government policies and is also able to report on police abuse and corruption without being harassed by

the government. The government does not restrict access to the internet. It also does not monitor e-mail correspondences and internet chat rooms or block web sites. Internet use however is limited by the inability of much of the population to buy a computer, the low electrification rate and the poor telecommunication infrastructure. Freedom House ranks Papua New Guinea 26 of 195 in its Freedom of the Press survey for 2009 and characterizes the press as "free."

Freedom of religion, academic freedom and freedom of association are respected. Freedom of assembly is curtailed by the regulation that 14 days' notification be provided for a demonstration. The police have at times denied permission for a demonstration because of safety and security concerns. NGOs are allowed to operate without government interference. Workers are allowed to form and join unions, strike and engage in collective bargaining. Unions have to register with the Department of Labor and Industrial Relations. The registration process though is not especially onerous and is not used by the government to restrict union activity. About half of the approximately 250,000 wage earners in the formal economy are members in one of the 50 trade unions. The government has frequently intervened in labor disputes by ordering the parties to adhere to arbitration in order to prevent a possible strike. It also has the authority to cancel arbitration awards and declare wage agreements void when they are contrary to government policy.

The judiciary is independent. Lengthy pretrial detention of suspects and long trial delays are common because of inadequate resources and lack of trained personnel. There have been allegations that the police have committed unlawful killings, extortion, rape, theft, the sale of firearms, and have used excessive force in the arrest and interrogation of suspects. In 2007, the Ombudsman's Commission named the police department as the most corrupt government agency. To make an arrest, the police do not have to obtain a warrant. Instead the police can arrest a suspect on the "belief" that a crime was committed, is in the process of being committed, or will be committed. There are no juries. Instead, judgments are rendered by judges. Tribal feuds over land, titles, religious beliefs, and perceived insults have frequently resulted in violence and deaths.

II. Economic Overview

Papua New Guinea is a largely agrarian based society whose economy is increasingly dominated by the exploitation of mineral deposits such as copper and gold. It is on the verge of a major windfall as foreign oil companies begin the commercialization of natural gas deposits and the construction of liquefied natural gas facilities. As in the case of many resource rich countries, there are concerns that this windfall will fuel corruption.

Agriculture, forestry and fishing accounted for 34.7% of GDP in 2007, mining and quarrying had a 28.2% share, construction represented 9.4% and community, social and personal services were 8.7%. Manufacturing was just 5.8%. About 85% of the workforce is employed in agriculture, much of which is subsistence in nature. The official unemployment rate was 1.9% in 2004. The Bertelsmann Country profile for Papua New Guinea however noted that "Unemployment is estimated to be higher than 70% and more than 80% of the population relies on subsistence farming or the informal economy for their daily needs."

On January 28, 2010, the National Minimum Wages Board approved an increase in the minimum wage to \$103.64 every two weeks from \$22.63 effective January 21. This was the first change since 1992 when the minimum wage was lowered by 63.3%. The trade union federation estimated that 50% of the wage earners in the formal economy would benefit from the increase. The legal workweek is 42 hours in urban areas and 44 hours per week in rural areas. Premium pay must be made for overtime work. Regulations concerning working conditions, overtime and health and safety conditions are not effectively enforced because of a shortage of inspectors.

The minimum age for employment is 16. For hazardous work, it is 18. Children between the ages of 11 and 18 can work in a family business provided they have parental permission, a medical clearance, and a work permit from a labor office. In addition, the work they perform must not interfere with school attendance. The national youth minimum wage, for the ages of 16 to 21, is set at 75% of the adult minimum wage.

The economy rose at an annual average rate of 3.6% between 2000 and 2009. This compares to advances of 5.1% for Indonesia, 4.6% for the Philippines and 2.9% for Australia. According to the IMF, the per capita income in 2009 was \$1,294. This was 88.5% above the level of 2000. Papua New Guinea is ranked 128 of 180 nations and territories that the IMF compiles per capita data for.

Consumer prices rose by 1.8% in the third quarter of 2009 (CPI data is issued quarterly) and was 5.3% above its year ago levels. This compares to a 13.5% annual rise in the year ending September 2008. In its November budget statement, the government estimated that consumer prices rose by an annual average rate of 7.4% in 2009. This compares to an increase of 10.7% in the previous year and 0.9% in 2007. For 2010, the government is forecasting a 9.5% annual increase. Consumer prices advance at a 7.7% annual average rate between 2000 and 2009.

The main crops and agriculture products are coffee, cocoa, copra, palm kernels, tea, sugar, rubber, sweet potatoes, apples, breadfruit and vanilla. Gold, copper, silver, natural gas, timber and oil are the major natural resources. Palm oil processing, plywood production, gold, silver and copper mining; crude oil production, petroleum refining, construction and tourism are the principle industries.

1. Infrastructure

There are 19,600km of roads of which just 3.5% are paved. The US Department of State Travel Advisory noted that "Traffic moves on the left. Travel on highways outside of major towns can be hazardous...Roads are generally in poor repair, and flat tires occur routinely as a result of potholes and debris on the roadways. During the rainy season, landslides can be a problem on some stretches of the Highlands Highway." According to the World Bank, 35% of the population lives more than 10 km from a national road and 17% from any road at all. The Asian Development Bank (ADB), the World Bank and Australia are providing financing and grants to improve the dilapidated road network.

There are 560 airports of which 21 are paved. Jacksons International Airport, also known as Port Moresby Airport, is the main international airport. It is located 5 miles outside the capital and is the main hub for Air Niugini, the national carrier which was established in November 1973. It is 60% owned by the government, 16% by Ansett, 12% by Qantas and 12% by Trans Australia Airlines. The airport is also the main hub of Airlines PNG, which is a private carrier. No major international airlines service the airport. There are flights to Brisbane, Cairns, Honiara, Hong Kong, Kuala Lumpur, Manila, Nadi, Singapore, Sydney and Tokyo (Narita). The airport is operated by the civil aviation authority, which is a government agency.

There is no railway system.

There are 22 ports, most of which are small and in poor condition. PNG Ports Corp. Ltd, a state owned company, operates 16 of the 22 ports. The major port is at Lae, which accounts for 50% of the revenue of Ports Corp Ltd. Port Moresby, Madang, Kimbe, and Rabaul also handle international cargo. On December 20, 2007, the ADB announced that it, along with several international institutions, including the OPEC Fund for International Development, will provide \$108.25 million in financing to upgrade and expand the port of Lae. According to the ADB, "In 2005, the volume of cargo through Lae reached 2.4 million tons, stretching it to the limit of its capacity. Frequent congestion at the port results in high costs for users and hampers international and domestic trade." The upgrading project involves expanding the cargo handling capacity, constructing a multipurpose berth, expanding storage areas and improving the drainage, electricity, water and sewage systems.

In rural areas, just 20% of the population has access to clean water while in urban areas, 91% of the population has access to clean water but only 60% of households get piped water directly into their house. Poor water and sanitation conditions were a major factor for the outbreak of cholera from the summer of 2009 to early 2010 that killed 45 people. The MD Travel Health travel advisory for Papua New Guinea urged tourists "not drink tap water unless it has been boiled, filtered or chemically disinfected."

2. Energy Sector

Oil production in 2008 was 38,100 barrels per day (bpd). This is down sharply from peak output of 125,880 bpd in 1993. Proven reserves are 88 mn barrels, which is six and a third years of production at the 2008 extraction rate. Oil consumption is 31,000 bpd and exports are 7,000 bpd. InterOil Corporation (Canada) completed the construction of the only oil refinery in 2004. It took 3 years to build, cost \$185 mn, is located in Port Moresby and has a capacity of 32,500 bpd. The refinery provides all the domestic needs and exports about 35% of its output. InterOil has the largest wholesale, retail and aviation petroleum product distribution operation in the country as a result of its acquisition of BP's entire commercial and retail distribution assets in April 2004 and the acquisition of Shell Papua New Guinea on October 1, 2006. It is responsible for supplying 70% of all the refined petroleum products. InterOil is also involved in exploring for oil.

Oil Search Ltd. (Australia) has a major presence in the oil sector. It is 17.6% owned by the government of Papua New Guinea. In 2003, it bought out Chevron/Texaco's holdings for \$96.6 mn. Santos Oil (Australia) and Nippon Oil Exploration (Japan) are also involved in exploring for oil. In 2009, Talisman (Canada) bought Rift Oil Plc (UK), which had oil interests in Papua New Guinea.

A modest amount of natural gas is being produced. There are however tremendous deposits that are being developed. PNG Gas is the largest natural gas project. It is developing the Southern Highlands field and constructing a liquefied natural gas (LNG) facility that is expected to begin to export LNG in 2015 or 2016. The LNG plant will have capacity of 6.3 million tons per year. PNG Gas is a consortium whose largest shareholder is Exxon/Mobil, which has a 41.6% interest. Oil Search Ltd has a 34.1% stake, Santos has 17.7%, Nippon Oil Exploration owns 5.4% and MRDC, a domestic company representing landowner interests, has 1.2%. Ultimately, the government of Papua New Guinea is expected to acquire an 18%-20% stake in the project. The development of the gas fields and the construction of the LNG plant is expected to cost \$15 bn. On December 3, 2009, Sinopec Corp (China) signed a 20-year agreement to buy 2 million tons of LNG from PNG Gas.

Liquid Niugini LNG is another LNG project. It is being developed by PNG LNG Inc., a Bahamas-based parent holding company that is owned by InterOil, which has a 52.5% stake and Pacific LNG Operations Ltd (a division of Clarion Finanz of Germany) which owns 47.5%. The LNG terminal will be built adjacent to the InterOil's oil refinery in the capital. Bechtel will design the LNG facility. It is expected to be finished in 2012. InterOil and Pacific LNG Operations are involved in a second LNG project with Petromin, the government owned energy company, which will have a 22.5% ownership stake in a \$7.0 bn project to develop a natural gas field and build a LNG facility that is expected to be completed by 2015.

The electrification rate is just 7.0%. Hydro-power generates 28.8% of electricity and thermal power (mostly oil) the remainder. Electricity is provided by the state owned PNG Power Ltd Company.

3. External Accounts

The global recession and the fall in oil and copper prices prompted a substantial drop in the trade surplus in 2009. It retreated by 67.7% in the first three quarters to K2,864.5 mn (\$1.049 bn at the end of September 2009 exchange rate) as exports tumbled by 44.7% and imports dropped 13.5%. Gold accounted for 45.8% of exports in the first 9 months of 2009 followed by copper at 16.3% and crude oil with a 13.7% share. The major imports are machinery, capital goods and transportation equipment related to the development of the natural gas sector and the mining industry. Australia was the largest export market during the first three quarters of last year with a 47.0% share followed by Japan at 13.9% and the Philippines was responsible for 7.2%. With respect to imports, Australia was also in first place with a 42.1% share. In second place was the US at 22.2% and Singapore was third with 11.2%.

Worker remittances are not an important source of transfer income. According to the World Bank, they totaled just \$13 mn in 2008 and were equal to just 0.2% of GDP. Tourism has been of growing importance with the number of tourist arrivals increasing from 67,000 in 1999 to 114,000 in 2008. The tourist sector however still represents a small portion of the economy. According to estimates of the World Travel and Tourism Council, the travel and tourism industry will account for just 0.7% of

employment (direct impact) and 0.9% of GDP in 2010. A Euro-monitor Report on the travel and tourism sector highlighted the inadequacies that plague the tourist industry and prevent it from becoming a more important contributor to the economy. It said, "With 800 cultural groups, each with their own language, numerous active volcanoes and an extensive collection of islands, Papua New Guinea is a unique country with an attractive tourist proposition...it has an undeveloped tourism infrastructure. There are practically no major roads...long-distance transport is facilitated by an over-priced air service. The country also has a reputation for being dangerous, with political turmoil, inter-tribal warfare, armed hold-ups of vehicles and gangs commonplace...there is a complete absence of luxury resorts."

There is a large net deficit in the income category as a result of the repatriation of income from the mining and energy sectors. In 2008, the IMF estimated the net deficit was \$578 mn. This was equal to 7.0% of GDP. For 2009, the IMF estimates the net deficit fell to \$455 mn as a result of lower oil and mineral prices.

In response to the sharp decline in the trade deficit, the current account deteriorated markedly in 2009. In the first 9 months, there was a deficit of K905 mn (\$331 mn). This compared to a surplus of K2.068 bn in the similar period of 2008. The current account is likely to return to surplus in 2010 as a result of firming prices for many of Papua New Guinea's raw materials prompted by the recovery in the global economy. Spot copper prices for example, which averaged \$5,148 a ton in 2009, were trading at \$6780 a ton on March 2.

Foreign exchange reserves are at a very high level. As of September 2009, they were K6.155 bn. This was equivalent to 13 months of import cover (based on the data for the first 9 months of 2009).

4. External Debt and Budget Balance

Papua New Guinea is not eligible for debt relief under the IMF's and the World Bank's debt relief initiative for Highly Indebted Poor Countries (HIPC) because its debt burden is modest. The IMF has estimated that the public debt to export of goods and services ratio will be 20.1% in 2010 and the public debt to government revenue ratio will be 61.0%. This is well below the threshold levels for the HIPC Initiative of 150% and 250% respectively.

As of September 2009, the public debt (central bank, central government and statutory authorities) was K2.909 bn. This was down from a recent peak of K4.409 bn at the end of 2004 and was equal to just 13.0% of GDP. The IMF estimated the debt servicing ratio for the public debt in 2009 was just 2.1% of exports. As of the end of 2007, 36.3% of the public external debt was owed to the ADB, 27.5% to Japan and 23% to the World Bank. In addition to the public external debt there was \$894 mn in private external debt in 2007 of which 70.0% was owed by the mining sector.

The April 3, 2009 IMF Article IV Consultation Report noted that the government has been using the current account surplus to pay down its external debt. Although the IMF characterized the threat of debt distress as "moderate", it did indicate that the external debt is likely to rise in the coming years as a result of borrowings and guarantees associated with LNG projects, the large unfunded pension liability and the poor financial condition of many state-owned enterprises. The external debt though is expected to remain at manageable levels.

In the first 9 months of 2009, there was a budget surplus of K541.3 mn. This was down 38.9% from the similar period of 2008. The surplus was equivalent to 2.6% of GDP. Total revenue (including grants) fell by 11.6% as a result of lower direct tax payments from the mining sector, which offset a modest increase in indirect taxes (mainly goods and services taxes). Foreign grants climbed by 16.1% to K108.2 mn. They were equal to 2.7% of total revenue. Government spending dropped 5.1%. Interest payments rose by 11.4% and accounted for 7.2% of total spending. Despite the budget surplus in the first 9 months, the government expected there would be a budget deficit of 0.4% of GDP for the full year. In 2008, there was a deficit of 2.2% of GDP and in 2007, there was a surplus of 2.5% of GDP. The 2010 budget, which was released in November, foresees a balanced budget with spending rising by 11.4% and revenue climbing 12.8%. The budget contained no new tax increases, tax concessions or increases in current taxes.

5. Agriculture Sector

Much of agriculture is subsistence or semi-subsistence in nature. Agricultural productivity is low because of poor irrigation infrastructure, inadequate investment, small farm size, lack of modern farming techniques and equipment, inadequate electricity, lack of access to credit and poor rural roads. The main cash crops are coffee, cocoa, copra, tea, rubber and sugar. In recent years, a palm oil industry has been developed. It is now the largest agriculture export. In 2007, it accounted for 4.8% of all exports. Coffee had a 2.9% share, cocoa was responsible for 1.9% and coconut oil had a 0.8% share. With respect to food imports, rice accounted for 1.6% of all imports, sheep meat was 1.4% and wheat was 1.0%.

Rice is the main staple crop, accounting for 16.4% of caloric intake in 2003-2005. Wheat was second with an 8.2% share. Meats, offals, milk, eggs and fish accounted for 14.8%.

Much of the country is covered with forests trees. A domestic woodworking industry however has been slow to develop. In the first 9 months of 2009, forestry products (mostly logs) accounted for 3.4% of total exports. The World Bank and other donor countries have ceased providing financial support for the logging sector because of concerns about deforestation and environmental damage. Greenpeace has alleged that 90% of all logging is illegal because of the lack of prior approval and informed consent from traditional landowners and the failure of the government to enforce its own forestry laws. It has charged that “the majority of logging operations are environmentally, economically and socially unsustainable.” In March 2008, the government pledged to phase out log exports by 2010.

6. Informal Economy

According to a study entitled, “Shadow Economies and Corruption All Over the World: New Estimates for 145 Countries,” by Fredrich Schneider of Johannes Kepler University in Linz, Austria, the informal economy in 2004/05 was equal to 37.3% of GDP.

Subsistence farming accounts for the bulk of the informal economy.

On January 8, 2010, the government announced that the revamped Customs Agency will “vigorously crackdown on syndicates that facilitate smuggling activity”. Customs Commissioner, Gary Juffa indicated there was evidence of smuggling of drugs, wildlife and humans.

III. Business Environment

Index	Rank	Score
Economic Freedom of the World Index 2008	87/141	6.4/10.0
Heritage Foundation Economic Freedom Index 2010	126/179	53.5/100.0
World Economic Forum – Global Competitive Index 2009-2010	N/A	N/A
Milken Institute Capital Access Index 2008	76/122	4.01/10.00
UNCTAD – Inward Potential Performance Index 2005-2007	128/141	0.240/10.000
World Bank Ease of Doing Business 2010	102/183	N/A
World Bank Gov Indicator 2009, Regulatory Quality	30.4 Percentile	-0.59
World Bank Gov Indicators 2009, Rule of Law	18.2 Percentile	-0.94
Transparency International Corruption Perception Index 2009	154/180	2.1/10.00

1. Summary of Indices

Papua New Guinea ranks 102 of 183 in the World Bank's 2010 ease of doing business survey. This compares to a ranking of 95 in the 2009 survey. It is ranked 104th for starting a business, 26th for employing workers, 135th in getting credit, 162nd in enforcing contracts, 83rd in registering property, 41st in protecting investors, 96th in paying taxes, 89th for trading across borders, 121st for dealing with construction permits and 104th in closing a business. With respect to the World Bank's governance indicators, it performs below average. It is ranked at the 30.4 percentile for regulatory quality and at the 18.2 percentile for rule of law.

Papua New Guinea is ranked 126 of 179 in the Heritage Foundation's Economic Freedom Index, it is ranked 76 of 122 in the Milken Institute Capital Access Index, it is ranked 87 of 141 in the Fraser's Institute Freedom of the World Index, it is not ranked in the in the World Economic Forum's (WEF) 2009-2010 Competitiveness Index and it is ranked 128 of 141 in the UNCTAD Inward Potential Performance Index.

2. Openness to Foreign Investment

The government encourages foreign investment to spur economic growth, exports and employment. Property can only be nationalized or expropriated "in accordance with the law. Foreigners can own 100% of a domestic company and can freely form joint ventures with either local companies or other foreign companies. All foreign investment must be submitted to the Investment Promotion Authority for approval. If the application is approved, a certificate is granted that will allow the company to begin conducting business and enable it to obtain business visas. Foreigners cannot own land but can lease it for up to 99 years. There is an arbitration process in the event of commercial disputes

There are foreign exchange controls but most are not particularly onerous though they can be time consuming as they involve filling out and submitting forms for approval. All remittances in excess of K50,000 per year require a tax clearance certificate and all annual remittances over K500, 000, with the exception of payments related to trade-related goods, must be approved by the Central Bank. There are no restrictions on the remittance of capital by a non resident. Payments for interest on loans, rentals and insurance premiums and the payment of dividends must be accompanied by supporting evidence documenting the stated purpose of the payment. There are no restrictions on the payment for imports as long as proper documentary evidence is provided.

The Central Bank administers the foreign exchange controls. It also has to approve all foreign investment proposals including those involving the borrowing of funds from a non-resident investor. The holding of foreign currency by residents and non residents is not encouraged. Exporters are usually required to convert any foreign exchange received into kina. The transfer of funds for many transactions such as paying interest on loans, the purchase of securities and payment for royalties and management licenses require a tax clearance certificate.

The government offers generous incentives for investing. Investors for instance are entitled to a 10-year tax holiday for setting up businesses in rural areas while there is a 3-year tax exemption for companies setting up businesses to export certain goods such as motor vehicles, paint, refined petroleum, soap, wooden furniture, dairy products, clothing and manufactured textiles and jewelry.

3. Taxes

There is no personal income tax on the first K7,000 of income. Thereafter, the rates range from 22% to 42% for income over K250,001. The brackets for non-residents are 30%-42% with the 42% rate also applying to income over K250, 001. Dividends paid by resident companies are subject to a withholding tax of 17.0% (mining companies pay a withholding tax of 10%). Dividends however are exempted from personal income taxes. The withholding tax for interest is 15%. Income from unit trusts including property unit trusts are exempted from personal income taxes. Employees pay a social security contribution of 6.0% of gross salary (excluding bonuses, overtime and commission) and employers contribute 8.4% of gross salary. The corporate tax rate is 30% for resident companies and 48% for non resident companies.

The corporate tax rate for petroleum companies is 50% for companies that had profits before December 31, 2000. There is a 40% tax rate for those oil companies that did not have any profits before December 31, 2000. Overseas losses incurred by businesses and individuals cannot be deducted from domestic sourced income. The Goods and Services Tax (GST) is 10%. There is no GST on prescription drugs, eyeglasses and financial, education and medical services. There are no gift and capital gains taxes.

4. Foreign Investment

Data from the UNCTAD indicate that there was a net decline of \$30mn in foreign investment in 2008. The total stock of FDI (book value) at the end of 2008 was \$2.312bn, which was equal to 28.6% of GDP and was 15.9% above the level of 2000.

Much of the foreign investment is in the oil, natural gas and the mining sectors. Inmet Mining (Canada) owns an 18% stake in the OK Tedi Copper mine, the largest mining operation in the country. The PNG Sustainable Development Program Limited, a government entity, has a 52% holding in the venture and the government entity PF Papua New Guinea owns the remaining shares. Xstrata Mining (Switzerland) is also involved in a project mining copper. Among the gold mining companies are Barrack Gold (Canada), Vangold (Canada), New Guinea Gold (Canada), and Lihir Gold (Australia). On April 23, 2008, Newcrest Mining (Australia) paid \$525 million to Harmony Gold for the rights to co-develop a gold mine. Among the other mining companies are Frontier Resources (Australia) and Highland Pacific Ltd. (Australia).

Four Chinese companies have formed a syndicate to take an 85.0% stake in the Ramu nickel and cobalt mine. Highlands Pacific has an 8.56% share, Mineral Resources Development Company Limited, a 100% State owned company has a 3.94% stake and a company representing the interests of the landowners has a 2.50% holding. Development of the mine began in late 2009.

RD Tuna Cannery (PNG) Ltd., a subsidiary of the RD Group of the Philippines, employs 3,000 people in tuna cannery operations. Rimbunan Hijau (Malaysia) is involved in logging. Digicel (incorporated in Bermuda and based in Jamaica) was awarded an operating license in November 2008, effectively ending the government's monopoly on mobile and fixed-line telephone services.

5. Financial Sector

There is a small and shallow banking system that is mainly concentrated in urban areas. There are just 4 commercial banks; Bank of South Pacific (locally owned), ANZ, Westpac and Maybank (Malaysia). Bank of South Pacific is the dominant banking institution accounting for 50% of banks assets and deposits. ANZ is the next largest with a 31% share. There are also 21 Savings and Loans and 5 life insurance companies. The cost of credit is high, thus limiting the development of the private sector. Most bank lending is of a short-term duration. The IMF Article IV Consultation report noted that the banking system was not undermined by the global financial crisis and that banks are very liquid. According to the IMF, the balance sheets of the banks are mostly funded by domestic currency deposits. Non-performing loans were placed by the IMF at just 1.3% of total loans outstanding. Foreign currency deposits, which might be vulnerable to being withdrawn in a financial crisis, make up just 5% of total bank assets and are held by the 2 Australian banks. As of September 2008, 15.6% of the loans outstanding were to the retail trade sector, 8.3% were to manufacturing and 7.1% were for housing.

The Central Bank is independent and is in charge of overseeing monetary policy and regulating the financial system. It issues weekly treasury bills. There is however no effective secondary market for Treasury Bills. At the auction on February 24, 2010, the yield for 91 day TBs were 7.00%, for 182 days, it was 6.27% and for 365 days, it was 7.43%. The Central Bank's main benchmark interest rate is the Kina Facility Rate (KFR). It has been 8.00% since December 2008. The Central Bank's repo-rate meanwhile has been 9.00% since December 2008.

There is a stock exchange, the Port Moresby Exchange, which is run by a private company. There are 20 listed companies, several of which are dual listings with Australia. Trading is very light. In 2008 for example, there were an average of just 33 transactions per day.

The kina operates under a managed floating currency regime. The market for the currency is relatively illiquid and as a result, the spread between the bid and ask prices are high in comparison to the major currencies. In its Article IV Consultation report the IMF characterized the kina as being “mildly overvalued”. In 2009, it dropped by 0.9% against the US dollar and retreated by 18.0% against the Australian dollar. In the year to date period ending March 2, it depreciated by 1.7% against the US dollar and dropped 0.8% against the Australian dollar.

6. Corruption and Transparency

Papua New Guinea has ratified the UN Convention Against Corruption. It is ranked 154 of 180 nations in Transparency International’s 2009 corruption perception index. In the 2008 survey it was ranked 151 of 180 nations. According to Transparency International, a score of less than 3.0 out of 10.0 indicates there is “rampant” corruption. Papua New Guinea has a score of 2.1.

There are laws that provide for penalties for official corruption but they are not effectively enforced. According to the US Department of State Human Rights Report, “Corruption at all levels of government is a serious problem due to weak public institutions, leadership, and governance; lack of transparency; politicization of the bureaucracy; and the use of public resources to meet traditional clan obligations.”

In April 2008, the Auditor General released a report that indicated corrupt officials stole about \$318 million annually in recent years. Several prominent officials, including Prime Minister Michael Somare, were implicated in 2008 for the disappearance of \$30 million in assistance from Taiwan. Somare attempted to cite executive privilege to avoid being investigated but the National Court ruled the Ombudsman’s Commission could continue its investigation into the Prime Minister. No charges though were brought against him. In April, 2008, Isaac Lupari, the finance department’s chief secretary, resigned when it was revealed that \$70 million was missing from the department’s accounts.

7. Standards Compliance Assessments

IMF Dissemination Standard	Subscription Status
Special Data Dissemination Standard	Not a subscriber
General Data Dissemination Standard	Not a subscriber

IMF Assessment	Standards Assessed	Dates	Compliance Level
Reports on Standards and Codes (ROSCs)	Fiscal Transparency	Oct 11, 2000	Low
Financial Sector Assessment Programs (FSAPs)			

Papua New Guinea has been assessed with respect to Fiscal Transparency through the IMF ROSCs Program. In its report, the IMF noted that “lack of information on general government operations and noncompliance with legal reporting and fiscal management requirements are major problems” that need to be addressed.

IV. Human Capital

Index	Rank	Score
UNDP Human Development Index 2009	148/182	0.541/1.000

1. Social Indicators

Papua New Guinea is ranked 148 of 182 in the 2009 UNDP HDI. The infant mortality rate is 44.6 per 1,000 live births, the probability of dying before the age of 40 is 15.9%, 39.0% of births are attended to by a skilled health care professional, the under 5 mortality rate is 65 per 1,000 live births, 58% of one-year olds are fully immunized against measles, the maternal mortality rate is 470 per 100,000 live births, 40% of the population have access to clean drinking water, 45.0% of the population have access to improved sanitation facilities, the probability of dying between the ages of 15 and 60 is 27.3%, 57.4% of the population lives on less than \$2 a day, 37.5% of the population lives below the national poverty level and the projected life expectancy for 2010 (according to the US Census Bureau) is 66.0 years (68.3 years for females and 63.8 years for males).

Papua New Guinea is one of the 77 "Low Income Food Deficit Countries" as defined by the Food and Agriculture Organization.

2. Access to Technology

There are 9 mainline telephone lines and 47 cellular subscribers per 1,000 people. Internet use is 18 per 1,000 people. There are 64 personal computers per 1,000 people, 10% of households have a television and there are 73.9 radios per 1,000 people. In 2007, there were 59,645 motor vehicles of which 64% were cars, 2% were 2 and 3 wheelers, 18% were trucks, 11% were buses, 2% were motorized 2-3 wheelers and 2% were minibuses and vans with a capacity of less than 20 passengers. The per capita consumption of electricity is 446 kilowatt hours (in the US, it is 12,924 kilowatt hours).

3. Health Indicators

There are 10 physicians per 100,000 people and 50 nurses and midwives per 100,000 people. According to the WHO, there were just 90 dentists in 2000.

The prevalence of HIV/AIDS is 1.5% of the adult population (15-49 years old). This is above the 0.4% average for Oceania. In 2007, there were 54,000 people living with AIDS of which 21,000 were women 15 and over and 1,100 were children between 0 and 14. The prevalence of tuberculosis is 430 per 100,000 people (in the US, it is 3 per 100,000 people) and the tuberculosis death rate is 60 per 100,000 people. The prevalence of diabetes is 2.1% of the population between 20 and 79 (the average for the Western Pacific is 5.0%) and the prevalence of obesity is 2.5% for males and 5.2% for females. There were 1,508,013 cases of malaria and 60 deaths from malaria in 2006. The per capita health expenditure in 2006 was \$62 and the total expenditures on health were 3.2% of GDP. The mortality rate for cancer is 118 per 100,000 people, the mortality rate for cardiovascular diseases is 442 per 100,000 people and the deaths due to HIV/AIDS are 56 per 100,000. The homicide rate in 2004 was 15.2 per 100,000 people. In 2007, there were 237 road traffic accident deaths.

A WHO Health Situation and Trend Report painted a bleak picture of the health conditions in the country. The US State Department Travel Advisory noted that "Medical facilities... vary in quality, but those in the larger towns are usually adequate for routine problems and some emergencies. However, equipment failures and sudden shortages of common medications can mean even routine treatments and procedures (such as X-rays) may become unavailable...Pharmacies are found only in urban centers and at missionary clinics. They are small and may be inadequately stocked." In the WHO's ranking of the world's health care systems, Papua New Guinea is ranked 148 of 190 countries.

4. Education Indicators

Primary education is not free, compulsory or universal. There are charges for tuition, books and school supplies that are beyond the means of many parents. Many children end their schooling at the completion of primary school. Secondary education is offered to only about 1 in 6 children, and fewer than 2% of students who enroll in secondary education reach the last grade. Primary school begins at age 7 and lasts for 6 years. Of the students who enroll in grade 1, 58% reach the last grade of primary school. The pupil/teacher ratio in primary school is 35:1. Secondary education begins at age 13 and lasts 6 years.

The Bertelsmann Transformation Index Country Report for Papua New Guinea noted that “The government allocates less than 2% of GDP to education. In many cases, the allocated sum is not paid out in full as the money is diverted to more pressing political issues. There is almost no state investment in research and development...There are four state universities and several private tertiary institutions...Many of the state universities are persistently under-funded, and academic staff strike over unpaid salaries and poor working conditions regularly.”

The adult literacy rate is just 57.8%. For females, the adult literacy rate is 53.4%. The adult literacy rate for the East Asia and Pacific region is 93.5%.

V. Economic Data, Outlook and Credit Rating

IMF Country Data Overview 2009 (Est.)							
GDP Growth	GDP:	GDP capita:	per	CPI:	Current Account as % of GDP	Budget deficit as % of GDP	FDI (UNCTAD 2008)
4.5% (Govt estimate)	\$8.200 bn	\$1,294		7.4% (Govt estimate)	-6.7%	-0.4% (Govt estimate)	-30 mn

1. Latest IMF Consultation

There has not been an IMF Article IV Consultation Report since April 3, 2009.

2. Economic Outlook

Papua New Guinea is on the verge of a tremendous windfall when the LNG facilities that are being constructed are completed in 3-6 years. They will fuel large increases in export and government revenue, which will provide the government with the resources to improve the poor infrastructure, boost spending on health and education, diversify the economy away from the mining and energy sectors which create relatively few jobs and reduce widespread poverty.

The government has shown itself to be relatively conservative with respect to spending the revenue from the mining and energy sectors. The foreign debt for instance has been pared, foreign exchange reserves have been accumulated and there has been no spending spree that has plunged the budget sharply into deficit. In November, the government announced that it was considering establishing a Sovereign Wealth Fund to manage its share of the revenues from the LNG projects. The economy in this regard can only absorb a modest amount of the LNG earnings without sharply boosting inflation, overwhelming the small banking system and financial markets and fueling an already high level of corruption. The government has estimated that the PNG LNG project alone will generate \$50bn in revenue over a 30 year period when it becomes operational in 2015 or 2016.

3. Country Credit Ratings

Credit Rating	Standard & Poor's	Moody's	Fitch Ratings
(as of date of publication)	B+/Stable/B	B1/Stable	N/A

Papua New Guinea has been rated by S&P and by Moody's. It was also rated by Fitch but on January 25, 2010, Fitch dropped its ratings review of the country.

S&P has assigned it a rating of B+/Stable/B, which is the same rating as Belize, Bosnia and Herzegovina, Cambodia, Mozambique, Nigeria, Senegal and Uganda. Moody's has given it a rating of B1/Stable. This is the same as Albania, Belarus and Suriname.

For S&P, a rating of BBB- or above is investment grade. Moody's investment grade rating is Baa or above.

VI. Membership in international organizations

Financial Action Task Force (FATF)	Not a member
International Center for Settlements of Investment Disputes (ICSID)	Entry into convention on November 19, 1978
International Federation of Accountants (IFAC)	Associate Member
Multinational Investment Guarantee Agency (MIGA)	Yes, a member
United Nations Convention Against Corruption	Ratified on July 16, 2007
World Intellectual Property Organization (WIPO)	Yes, a member
World Trade Organization (WTO)	A member since June 9, 1996

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