

**Institute of National Affairs, Rural Industries Council,  
Business Council of PNG, PNG Chamber of Commerce and  
Chamber of Mining and Petroleum**

**Comments on Report by Professor Robert Scollay**

**“Proposals for the Future of the Tariff Reform Programme”**

**General**

This report argues for a suspension of the planned tariff reduction for 2006. The planned reduction is rather small and is the final one in a series that have already been made:

**Timetable for Tariff Reduction Programme 1999-2006**

<b>Rate</b>	<b>1999-2000</b>	<b>2001-2002</b>	<b>2003-2004</b>	<b>2006</b>
Intermediate Rate	30%	25%	20%	15%
Protective Rate	40%	35%	30%	25%
Prohibitive Rate	55%	50%	45%	40%

Source: Scollay, R; from White Paper on Tariff Reform

The report acknowledges that all planned reductions except for the final step, due in January 2006, have been implemented. In other words the request is to halt a planned **5% reduction** in all tariffs. It seems unlikely that any viable business would be affected by a 5% reduction in tariffs and if it was we would query its long term viability and its benefit to the people of PNG as opposed to the owners and workers in the business.

Professor Scollay reports reductions in effective rates of protection ranging from 107% and an average of around 30%<sup>1</sup>. Companies that have been able to absorb these reductions would hardly be badly affected by a further reduction of just 5%. He further reports that the Tariff Reduction Programme (TRP) “was able to make substantial reductions in the penalty imposed on **export industries** by the tariff structure”<sup>2</sup>. It is worth noting that the fundamental policy of the Somare government is an **export led recovery** which even Scollay acknowledges will be helped by further tariff reduction.

The 2003 Tariff Review, commissioned by the State of PNG<sup>3</sup> went further than the agreed policy and recommended that reductions should continue for the next three

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<sup>1</sup> Scollay, R; *Draft report on Proposals for the Future of the Tariff reform Programme; Prepared for the Manufacturers' Council of PNG*; Port Moresby 2005, p. 3

<sup>2</sup> Ibid p3

<sup>3</sup> Duncan, R; Kiele, J, Temu,I; *2003 Tariff Review; A Review of the Tariff Reduction Programme*; Port Moresby 2003

years at 5% per year until no tariff exceeds 15%<sup>4</sup>. This submission agrees with that recommendation which will reduce costs to exporters and make PNG more competitive.

## **Recommendation**

This submission maintains that the tariff reduction should proceed as planned **but** that any industry that believes that it will be affected by the reduction should be allowed to ask for a stay of six months during which it would be given an opportunity to demonstrate that it is providing a **net benefit to the nation**. If it is unable to do so, the tariff reduction would be applied retrospectively by means of a fine equal to the amount of revenue the firm gained from the tariff.

## **Background**

The benefit from tariff reform is difficult to measure because it takes time to be felt in the economy. Efficiency gains are made by firms that adapt to reducing tariffs. The fact that the PNG manufacturing sector is expanding in an economy which has little overall growth shows that these industries have been able to adapt and become more efficient despite the other impediments to business that are contained in the report.

## **Scollay's Report**

Scollay reviewed the TRP and drew attention to its importance in achieving the Medium Term Development Strategy (p4) and concludes that the "rationale for the TRP remains valid" (p4), hardly the words of one strongly condemning the TRP? The report then goes on to say that 'a proliferation of these "special deals" would indeed seriously undermine support for government tariff policy' (p5) *but no such deals are or have been given recently* and therefore this is irrelevant.

Scollay also continually uses the "private sector"<sup>5</sup> as his source of information but he did not talk with the Institute of National Affairs, the Rural Industries Council, the Business Council of PNG, Chamber of Commerce or the Chamber of Mining and Petroleum. These bodies which together represent a large proportion of the private sector **were not consulted**, presumably because they did not support the halting of the TRP, a fact that the Manufacturers' Council was well aware of.

Scollay then goes on to say that business is unfavourably affected by a number of problems in the business environment (pp5-7). He says that there were "strenuous complaints ...raised over the failure of government to fulfil its 'side of the bargain', by implementing policies. that would improve the business climate". This **is agreed** to by the authors of this submission and include:

- Security and Insurance costs;
- Infrastructure;
- Transport Costs;

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<sup>4</sup> Ibid p. 16

<sup>5</sup> On p5 he says "The private sector representatives expressed serious concerns over the implications of implementing the next step of the TRP" which should have read "**some industries** rather than **private sector**".

- Utilities;
- Import Monitoring;
- Level of economic activity; and
- Inflation.

Many of these issues have continually come up for mention in the Consultative Implementation and Monitoring Council (CIMC) and many other forums including the Impediments Committee. To do anything about security and insurance, infrastructure and transport requires a major realignment of government thinking and resources.

The issue of **import monitoring**, on the other hand, could be achieved relatively cheaply and there are examples where such monitors have recouped their fees many times over e.g. Indonesia. The fiscal sub-committee of the Impediments Committee has recommended that PNG employ such external monitors as soon as possible.

The suggestion that growth has only occurred in the mining and extractive industries is an opinion and does not stand up to scrutiny. The Bank of PNG Quarterly Economic Bulletin reports that there was a growth of 7.7% in employment in the **manufacturing** sector in the June quarter of 2005. The main increases were a company employing more casuals to move inventories, hiring of staff by new companies and increased production from a major loining plant in Wewak<sup>6</sup>, hardly the profile of a sector hard hit by the TRP?

One of the problems is that the retail and wholesale industries are undergoing a major structural change which is closely related to the issue of import monitoring, traditional retailers are being challenged strongly by new competitors and finding it hard to compete and they allege that the new wave of retailers are not necessarily meeting all their tax obligations. The value of imports grew by 300 million between 2003 and 2004 whilst exports of agricultural products grew by K500 million in the same period, mineral petroleum exports grew by a much lower figure of K200 million<sup>7</sup>.

Agricultural exports can generally be expected to translate into economic activity because most industries are dominated by smallholders with an extremely high propensity to consume.

With regard to **inflation** it is claimed that “private sector representatives are sceptical of inflation figures”<sup>8</sup>(p7) and draws attention to the pricing formula of the Port Moresby refinery. The refinery would have a ‘once-for-all’ effect on inflation when the new formula was introduced which gave the definition of import parity as the “posted price” which is around \$US5/barrel more than the spot price. After that it is tied to the movement in world prices and would track that price almost exactly. It would not have an effect on inflation which measures the change in price from period to period. In the absence of any better information we have no alternative to using the Consumer Price Index as the only measure of inflation and it is used for most other decisions relying on inflation.

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<sup>6</sup> Bank of PNG, *Quarterly Economic Bulletin*, June 2005, p8

<sup>7</sup> Bank of PNG; *Quarterly Economic Bulletin*; March 2005, pS31

<sup>8</sup> Remember that large sections of the private sector were not consulted.

The Government (including the Bank of PNG) has managed to bring price increases under control by stabilising the exchange rate and keeping a lid on government expenditure. It is difficult to see what more it should be doing to control inflation.

On p8 the statement “there was also widespread support for the final scheduled step of the TRP should be suspended until the government has implemented policies to deliver promised improvements to business conditions” may be true about **some** industries but does not apply to all.

Scollay also said (p8) that many businesses had “streamlined their operations to achieve very significant cost increases”, an observation agreed by the task force<sup>9</sup>. This is to be expected with a TRP and is one of the main reasons for doing so. Even the alleged proponents of halting the TRP do not want it to be across the board because they use some imported inputs<sup>10</sup>.

Scollay’s arguments about **employment** at best establish that there could be conditions where the efficiency gains from a TRP would not encourage expansion of industry and therefore could cause unemployment. The problem with this argument is that it nowhere identifies one industry that is in danger of closing down from the proposed 5% tariff reduction. It again resorts to “consultations with private sector representatives” as the source of this worry, having carefully avoided talking to the very sectors where employment expansion is taking place! There is no argument that the economy needs to grow to provide jobs for the 80, 000 (not 42, 000) people joining the workforce<sup>11</sup> every year (almost 1 million children aged from 10-19 in rural areas and 150, 000 in urban areas; more than 300, 000 aged 15-19 are not attending school ).

There are a number of quite exciting mineral projects in the near future which will provide a several thousands of jobs and oil palm continues to expand. But they will not absorb many of the 5, 500, 000 Papua New Guineans that are not employed in the formal sector. There is no chance in the foreseeable future that the manufacturing sector will absorb significant numbers of these people and the few that may be displaced by a 5% tariff cut stand a better chance of being absorbed into the agricultural sector which will continue to benefit from the TRP.

The only way to absorb significant numbers is to encourage the informal sector which the government is doing and to encourage agriculture which already provides a living for 87% of the population. Halting the TRP will obviously adversely impact agriculture and this will be shown by a study in progress for the INA.

Scollay himself (and the Manufacturers’ Council) has suggested the best way of proceeding forward (p11) which is to commission an industry-by-industry review. However there is simply not enough time to do this before the 2006 budget and the TRP is scheduled to take effect.

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<sup>9</sup> Duncan et al p16.

<sup>10</sup> Maurice Brownjohn, personal communication 12/10/05

<sup>11</sup> 2000 census (rural) basic tables pp7, 35; urban p7.

## **Recommendation**

Those industries that believe that they provide a benefit to the nation as measured by social cost-benefit analysis should apply for and receive a temporary stay for 6 months. During that time they should produce evidence that they provide a net benefit to PNG and that they will be able to survive without protection within a finite period.

If the study fails to prove that the industry is worthy of protection the company should have to pay to the government all the additional income that it received as a result of the 6 month's protection.

## **Appendix 1. Recommendations of Tariff Review Task Force**

The Taskforce makes the following five recommendations:

**1. *That the existing schedule of the Tariff Reform Program remains in place.***

The Taskforce believes that on the whole the TRP has been successful in creating a more competitive manufacturing sector; it has also reduced the negative rates of assistance facing the agriculture, mining and petroleum and service industries; and it has benefited consumers, particularly the poorest.

Maintaining the announced schedule of tariff reductions will ensure that Government policy in the area of tariff remains consistent and predictable and that the benefits of tariff reform continue. Protected manufacturing industries have over two years before the next reduction in tariffs.

**2. *The Government should intensify its efforts to reduce the structural impediments facing Papua New Guinean businesses in the following areas.***

- . *Law and order;*
- . *Physical infrastructure;*
- . *Education and training;*
- . *The domestic shipping industry;*
- . *Public utilities;*
- . *Public sector performance; and*
- . *Macroeconomic management.*

These structural impediments in the PNG economy involve high and rising costs for all parts of society.

The Taskforce acknowledges the efforts already made by the Government to reduce the structural impediments to the PNG economy (such as its privatisation program and the national roads program) and that it takes time to make progress in these difficult areas. However, the Government's efforts need to be continued and intensified in order to create a conducive environment for business.

**3. *That the TRP be continued beyond 2006. From 2009, the prohibitive rate and the protective rates should be reduced by 5 per cent every three years until all tariffs are at 15 per cent.***

*All remaining non-advalorem tariff rates should be converted to the protective rate by 2006.*

*All goods should be subject to the uniform tariff rate of 15 per cent by 2021, except for those where it can be convincingly demonstrated that exceptional circumstances apply and that higher tariff would be in the 'public interest'.*

Given its success, the Taskforce believes the TRP should be continued so that the majority of Papua New Guinean businesses and consumers continue to benefit from the tariff reform. However, the Taskforce sees no benefit or justifiable logic in having three tariff rates. A universal rate will greatly improve and streamline customs administration. '

***4. That the Government should revive the Industry Assistance Board (IAB) and amend the Act to make it an independent statutory body and provide it with a sufficient budgetary allocation to perform its tasks.***

*The role of the board should be broadened to include the WTO and APEC secretariats currently located within the Department of Trade and Industry and Department of Prime Minister.*

*The IAB should have not more than three members, and should include at least one consumer group representative.*

*In response to call for special tariff assistance or customs administration issues, submissions should be brought to the IAB for evaluation using the following mandatory process:*

- *The IAB should first advertise that such assistance is being sought and call for public submissions. The IAB should consult with stakeholders, including affected businesses and consumer groups, and hold at least one public hearing.*
- *The IAB should evaluate the submissions, and make a recommendation to the National Executive Council for consideration.*
- *In evaluating the submissions, the IAB should make its recommendation based on the "public interest" test and undertake any necessary social cost-benefit analysis.*

*As tariffs are a tax, the Board should be located in the Minister for Treasury and Finance's portfolio and the Minister should also appoint board members.*

This recommendation is aimed at ensuring that any future changes to tariff rates are transparent and that a proper evaluation process is followed.

***5. That Customs administration should be improved in the areas of enforcement, monitoring and classification.***

Improvement in these areas would ensure that protected industries receive the assistance that they are entitled to and ensure that the appropriate amount of tariff review is completed.