

The Secretary

Independent Aid Review Secretariat

Dear Sir or Madam

The need for AusAID to support action by the PNG Government to build a vigorous 'informal economy'

I attach a document intended to inform the Review committee of current action by the Government of PNG to support and expand the productive contribution of the 'informal economy' in that country. However the argument has rather wider implications, in that the informal economy is relatively ill-developed in many small island states of the South Pacific. To a certain extent similar arguments apply in those countries.

In PNG the matter has some greater urgency because of the imminent resource boom, which will raise important issues of income distribution, social justice and development policy. My submission argues that efforts to expand the informal economy are a means of assuring that the benefits of the resource boom, rather than being confined to an 'enclave' of one or a few sectors in the 'modern' economy, will be more broadly distributed. The informal economy could become a mechanism to diffuse developmental pulses more effectively through the economy.

I am willing to supply further information or to meet the Committee members should this be felt useful by them. Although affiliated with the ANU, I am normally resident in Sydney.

Yours sincerely

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Papua New Guinea: the Informal Economy and the Resource Boom

Introduction

Towards the end of 2010 the Government of Papua New Guinea approved a *National Informal Economy Policy*. In its Decision # 172/2010, the National Executive Council endorsed the policy, appointed the PNG Department of Community Development as the 'lead implementing agency' tasked to 'coordinate implementation' and approved a small funding allocation for operational expenses. The NEC also 'directed the Constitutional Law Reform Commission to review the *Informal Sector Development and Control Act 2004* in collaboration with the Consultative Implementation & Monitoring Council (CIMC) Informal Economy Committee to align with the National Informal Economy Policy'.

What's in a name? A matter of terminology

One aspect of the policy – designed to influence perceptions of, and attitudes to, the issues – is concerned with *language*. What has hitherto been described as the 'informal sector' is now to be called the 'informal economy', in official parlance. This is to be done for two reasons: first, because it emphasizes the economic significance of the activities described (as distinct from their social and/or cultural significance), and second, because it underlines the responsibility of central economic policy agencies to support the growth and diversification of informal economic activities. The intention is to get away from the situation where Ministers (almost all men, by the way) regard the 'informal sector' as either a nuisance, or *samting belo ol meri tasol*¹.

A rationale for the policy

The policy document itself is not yet published, although an official launch is set for 24 February 2011. The rationale for an *Informal Economy Policy* was presented in a recent *Pacific Economic Bulletin*². It was adopted amid concern that the benefits of increasing economic activity in the resource-extraction sector – the 'commanding heights' of the PNG economy – will not flow through efficiently or equitably to the grass roots population. A better-functioning informal economy is seen as necessary to increase the efficiency of linkages between mineral enclaves and the broader population.

Among PNG's neighbour-states in Southeast Asia the informal economy is taken for granted. It is even regarded (rightly or wrongly) as an embarrassing indicator of backwardness, whose progressive elimination should be a policy objective. Whatever else they take from their travels, at least some PNG politicians seem to come back with the same view. So it might seem odd that in PNG the 'informal sector' should now be subject to official encouragement. Monetized informal economic activity is thought to need facilitation and support for several reasons. These include the relatively limited extent of such activity in PNG to date, together with the opportunities it presents for the poor. This situation reflects the continuing importance in PNG of a large non-monetized subsistence agricultural sector. An

¹ 'just something for women'

² See <http://www.microfinance-pasifika.org/a-national-policy-for-the-informal-economy-in-png.html>

informal economy inadequate in scale, scope and value represents a gap (a kind of ‘missing middle’) between the subsistence economy and the formal SME and corporate sectors.

A genuinely entrepreneurial class of PNG citizens in the middle and upper reaches of the economy has been slow to emerge (leaving aside the politically well-connected and other rent-seekers). This tardiness is at least partly due to the limited historical experience of ‘micro’-scale market economic activity in PNG, upon which budding indigenous entrepreneurs might build. Desultory government efforts to stimulate locally-owned and operated SMEs, conducted while ignoring or even repressing urban informal economic activity and largely neglecting the *rural* informal economy, have proved disappointing. Such a situation has political implications; for example, it underlies popular resentment of the activities of ‘new’ Asian retail enterprise, seen in widespread civil disturbances in recent years.

PNG is no stranger to the *enclave* model of resource extraction; successive mineral projects since the 1970s have confronted the immediate problem of satisfying local landowners, while governments have grappled with the larger issue of how to secure positive ‘spread’ effects through the whole economy. The huge new ExxonMobil LNG project, coming on-stream from 2014, promises to have major macroeconomic impact³. Real GDP could rise by 25 per cent at its peak, while the share of government revenues attributable directly to mining activities could rise very quickly, from 21 per cent of domestic revenue in 2010 to as high as 50 per cent by 2018. Grass roots populations might be expected to benefit from government spending, including transfer payments, resulting from a prudently-managed revenue surge. Were Government to succeed, in addition, in stimulating broadly-based domestic productive activity beyond the mineral enclave, this would multiply the benefits of resource extraction. But such a flow-on cannot be taken for granted in PNG under present conditions.

A poor supply-side response to high commodity prices has been noted in previous episodes, with the potential for growth constrained by factors including crime, expensive and unreliable utilities, deficiencies in transportation infrastructure and public services, regulatory barriers, skill shortages and land tenure issues. The need to avoid economic activity becoming ‘siloes’ in just a few sectors is widely understood. What may have been forgotten is that the supply response of the informal economy also needs to be improved, and that these constraints apply as much to it as to the formal sector. Microeconomic reform directed to reducing the costs of business and investment for the informal economy is necessary, so that it may contribute to the ‘localization’ of production and consumption by supplying a growing proportion of the consumption baskets of low income people and urban salaried workers.

How AusAID might assist

The *National Informal Economy Policy* focuses on two policy ‘arms’. The first of these is concerned with ‘financial inclusion’, on the assumption that access to financial services is the single most important policy area for facilitating the informal economy. The second policy arm is intended to address many of the constraints on economic activity described in the preceding paragraph. It is concerned with the adequacy of public goods and services of particular importance for the informal economy.

³ <http://www.eastasiaforum.org/2011/01/05/pngs-bumpy-road-to-high-growth/>

In regard to the first policy 'arm', AusAID has recently adopted a revised strategy for microfinance and financial inclusion⁴ which is consistent with the objectives of the *Informal Economy Policy*. The appropriate application of this new strategy in the PNG country program will be of considerable assistance to the PNG government's policy objectives for the informal economy. In regard to the second 'arm', it is recommended that AusAID, in its policy dialogue with the Government of PNG and in its support of infrastructure and services, should have regard to the needs of the informal economy and should attempt to identify and assist with the provision of public goods and services appropriate to those needs.

A final remark relates to the coordinating task of the Department of Community Development. It is understood that the Department will be substantially dependent on AusAID funding assistance for its immediate work program, due to the timing and paucity of the initial Budget allocation made by the NEC. If the policy is not to wither on the vine, AusAID's role as a champion of the informal sector and of the Department's role in implementation of the policy must be active and persuasive.

Conclusion

The relative 'underdevelopment' of the informal economy in PNG (especially when compared with neighbouring countries in monsoon Asia) is a complex phenomenon. The elements of an explanation may be found in aspects of traditional culture and technology, including the absence of monetized trade and exchange in PNG's many isolated traditional societies. The historically recent introduction of external colonial and economic influence to the island of New Guinea may have been another factor. To varying degrees, *mutatis mutandis*, the experience of a number of small states in the Pacific, especially in island Melanesia, has been similar. To that extent, any successful efforts at reform in PNG may prove to have some wider usefulness.

⁴ See http://www.ausaid.gov.au/publications/pubout.cfm?ID=3645_1909_4834_7583_9490