



Reducing agency problems in incorporated land groups

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The performance of Incorporated Land Groups in the petroleum sector, which were introduced as a mechanism for revenue distribution among landowners, suggests there are significant principal-agent problems arising from their design and oversight. This paper describes the problems that have arisen and suggests ways in which these agency problems may be reduced.

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Chevron Niugini (now ChevronTexaco) introduced Incorporated Land Groups (ILGs) as a benefits-disbursement mechanism when it developed the Kutubu Project in the early 1990s. The use of ILGs for resource rent¹ distribution among landowner clans in Kutubu has been adopted as standard practice across all post-Kutubu oil projects in Papua New Guinea. Their use is formally endorsed in legislation, particularly in Part IV of the Oil and Gas Act 1998.

Significant problems have arisen, such as the proliferation of (often 'ghost') ILGs, misuse of resource revenues by leaders of landowner groups, struggles over leadership of ILGs, land disputes, unfair distribution of benefits, and lack of accountability and transparency in the operation of ILGs. The PNG Department of Petroleum and Energy,

which is responsible for administering ILGs in this sector, has been overwhelmed with these problems and has been reviewing its policies and legislation, particularly the Oil and Gas Act 1998. The Department aims to make its policies and legislation more conducive to equitable benefits distribution among individual resource rent beneficiaries.

It is suggested here that these are mostly principal-agent problems arising from the poor design and lack of oversight of the ILGs—effectively, a failure of the government after it approved of these new institutions through legislation. After describing the development of ILGs, this paper details the problems that have arisen in their operation. It shows how these are primarily agency problems and then goes on to suggest ways in which these agency problems may be at



least reduced, if not eliminated. Given the backdrop of common property rights and resource management by customary groups (clans) prevalent in Papua New Guinea's rural societies, and the more-or-less egalitarian nature of such societies, this paper accepts as a basic assumption that the equitable sharing of benefit streams from resource projects should be the norm.

The use of ILGs in petroleum project communities

Brief overview of petroleum development

Oil and gas exploration has been undertaken in Papua New Guinea since 1911. The first sightings of hydrocarbons (oil seeps) were reported by gold prospectors in June 1911 in the Vailala area of the Gulf Province (Rickwood 1990). In the 1950s and 1960s, small and uneconomic oil and gas fields were found. The commissioning of the Hides project in the early 1990s (which produces gas and converts it into electricity for the power needs of the Porgera goldmine), became the stepping stone for the emergence of the petroleum industry. However, much of the current success of petroleum development can be attributed to the discovery of the Kutubu oil fields in the late 1980s. The Kutubu project, which came online on 28 October 1991, was the first commercial project producing hydrocarbon exports. On 27 June 1992 the first shipment of Kutubu's 'light sweet crude' was exported via the offshore marine terminal (the Kumul Platform) in the Gulf of Papua.

The South East Gobe oil field was discovered in 1991 and this '...was followed by further exploration wells, first on the South East Gobe structure and then on related structures' (AusAID 1998:198). The Gobe project, which began producing oil in April 1998 from two separate oil fields and therefore under two licences, has been

unified as a single petroleum project. Exploration outside the Kutubu and Gobe areas in 1995 and 1996 resulted in the discovery of the Paua and Moran structures. The Moran Project commenced commercial production under an extended well-testing program in February 1998. It became a commercially licensed operation in February 2001 when the government granted a petroleum development licence and recognised Moran as Papua New Guinea's third oil field. Papua New Guinea now has four main petroleum producing fields: Hides gas field, Kutubu oil field, Gobe oil field (which is made up of the Gobe Main and the South East Gobe oil fields) and the Moran oil field.

Benefits accruing to landowners from petroleum development

Benefits accruing to petroleum project area landowners are of two kinds. The first are the direct monetary or cash benefits—royalty payments and equity dividends. Under law, and in practice, royalties are disbursed on a monthly basis whilst equity dividends are paid quarterly to landowners. Both forms of payment are made through ILGs. The second are benefits in-kind, which are in the form of local business development opportunities, jobs and training opportunities, and provision of basic infrastructure and social services such as roads and bridges, schools, aid posts and health centres. It is the former type of benefits, the cash benefits, which are the focus of this paper.

Royalty payments are calculated at a rate of 2 per cent of the wellhead value of all petroleum produced from a licence area (s. 159 of the Oil and Gas Act 1998). To give an idea of the amount of money distributed through ILGs, Table 1 shows the total royalty payments, in cash, to Kutubu landowners, in particular the Fasu and Foe people,² over the period from June 1992 to December 1994. The royalty monies were distributed via ILGs to every Fasu and Foe family within the



project area. Records show that the Fasu received a total of K5,151,740 whilst the Foe received a total of K629,797 during this period. These funds comprise 60–68 per cent of the royalty payments. The other 33–40 per cent of royalties are paid into Future Generation Funds. This distribution between cash payments and payments into an investment fund recognises that oil and gas fields are non-renewable resources and future generations have a claim to the income derived from the exploitation of the asset.

The Fasu and Foe future generation funds were initially kept separately by the Fasu and Foe peoples in interest-bearing deposit accounts with commercial banks. However, due to these accounts being ‘tampered’ with by landowner leaders, the future generation funds were transferred to the Mineral Resources Development Company (MRDC)³ to manage on behalf of landowners through its subsidiary companies.

The other major form of direct benefit to petroleum project landowners is the dividends paid on their equity holdings in the petroleum projects. Under the Oil and Gas Act 1998 (s. 165), the state has the right

(but not the obligation) to take up to 22.5 per cent equity in any oil or gas project. The government retains 20.5 per cent. The balance of two per cent is to be shared among the project landowners and the local level government(s) within the project area through a negotiation process called a Development Forum (s. 167 of the Oil and Gas Act 1998).

The introduction of ILGs in petroleum project areas and their problems

With the development of the Kutubu oil fields, Chevron Niugini was faced with the question of how it could best distribute the royalties accruing to Kutubu landowners. At the time the government did not have a policy, let alone a conduit or mechanism, for the distribution of resource rents, particularly royalties and equity dividends, to landowners. It was then that the idea for the use of ILGs as a vehicle for the channelling and distribution of resource rents was conceived and implemented.

ILGs were also set up for landowners on whose land the oil pipeline was laid, as it wound its way from the highlands of Kutubu

Table 1 **Royalty payments to Fasu and Foe landowners, June 1992 to December 1994**
(kina)

	Fasu share of royalties (90 per cent)			Foe share of royalties (10 per cent)		
	Fasu total (100 per cent)	Fasu ILGs (60 per cent)	Fasu future generation (40 per cent)	Foe total (100 per cent)	Foe ILGs (67.67 per cent)	Foe future generation (33.33 per cent)
1992	883,899.90	530,339.94	353,559.96	108,056.22	72,037.48	36,018.74
1993	2,327,955.51	1,396,773.31	931,182.20	284,591.14	189,727.42	94,863.72
1994	1,939,884.83	1,163,930.90	775,953.93	237,149.73	158,099.82	79,049.91
Total	5,151,740.24	3,091,044.15	2,060,696.09	629,797.09	419,864.72	209,932.37

Note: The exchange rate up until 1994 was K1=A\$1

Source: Sagir, B.F., 2001. ‘The politics of petroleum extraction and royalty distribution at Lake Kutubu’, in A. Rumsey and J. Weiner (eds), *Mining and Indigenous Lifeworlds in Australia and Papua New Guinea*, Crawford House, Adelaide:145–56.



to the Kumul platform. The petroleum export pipeline runs from the Central Processing Facility in Kutubu to the coast via the Kikori River. The landowners along the Kikori River have been accepted as project area landowners. This is due to the fact that the entire pipeline route has been allocated a separate petroleum licence. Thus, the landowners along the pipeline right of way are considered project stakeholders. Whilst these landowners do not receive royalties, they were allocated a share of the equity of the Kutubu Oil Project accorded to landowners and so are recipients of quarterly equity dividends.

The ILG concept was later adopted for the Gobe and Moran Petroleum Projects, which were smaller oil fields that piggy-backed on the Kutubu Project's pipeline and processing plant infrastructure.

The following summarises the problems that have arisen with the operation ILGs (adapted from Marru 2002)

- ILG members not receiving benefits
- would-be beneficiaries missing out on benefits
- complaints of leaders misusing ILG funds
- lack of representation and responsibility of leaders
- land disputes
- leadership struggles
- lack of accountability and transparency
- unfair sharing ratios or disagreements over sharing ratios
- inability of ILG to resolve internal disputes
- lack of contact, communication and consultation with leader(s).

While the ILGs worked well in the early stages of the Kutubu Project, problems emerged thereafter. These problems have worsened with the emergence of splinter groups and the formation of additional ILGs.

Such outcomes were not envisaged either by the Department of Petroleum and Energy or by the developers. ILG problems have become so serious that a joint government–industry submission to the National Executive Council reported that

[t]he present regimes and procedures associated with ILGs now pose unacceptable risks for equitable distribution of benefits amongst project area populations, and for ongoing and future resource developments (Papua New Guinea 2002:4).

Leadership struggles. Landowner associations, incorporated under the Associations Incorporation Act No. 142, have been encouraged by the Department of Petroleum and Energy as political mouthpieces for petroleum project area communities. Associations are formed by all the ILGs belonging to distinct ethnic groups in the project area. Examples of such associations are the Namo'aporo Landowners' Association, representing the Fasu people, and the Foe Association, representing the Foe people, within the Kutubu Project. However, in recent times, landowner associations have become the focus of major political wrangling amongst landowners, not only within the Kutubu Project but also within almost all petroleum projects. Most of the heated debate is between different factions of the same ethnic group vying for leadership positions, and ultimately access to huge sums of money controlled (either directly or indirectly) by these associations. Such struggles for leadership positions are not limited to associations but are also occurring within landowner business corporations and the boards of various landowner companies controlling their equity share in the projects under the overall management of Mineral Resources Development Company.

Such leadership contests are one of the main factors behind the proliferation of ILGs.



Often, landowner leaders vying for the chairmanship of associations have been able to manipulate existing government systems to have additional ILGs incorporated—usually through the illegitimate registration of new ILGs—to inflate their ‘nominal representation base’ (Weiner 1998:9). This is done with the intention of attaining power and with it the means to acquire additional benefits through unscrupulous means. Potential chairmanship candidates often deceitfully advise ILG members that the more ILGs they have, the more money they will receive in benefits. Thus, the candidate will urge factions within an ILG to manipulate or construe their genealogical history to purport that they are separate sub-clans or lineages to an already existing ILG, which warrants independent ILG status (Goldman 1999:10).

Landowners view the chairman’s post within an association as a powerful and pivotal position, one that most aspiring and existing leaders envy very much. This is not surprising given the prevailing customary practice in the petroleum project areas of individuals vying to achieve ‘big man’ status (Rivers 1999:2). An example of this was witnessed in the Kutubu Project in 2000 when the incumbent chairman of Namo’aporo Landowners Association was challenged by an aspiring leader for the chairman’s post. The matter ended up in court, which ruled for the matter to be settled amicably outside of court. This eventuated in the incumbent having to pay his challenger hundreds of thousands of kina to ‘keep him off his back’ and have the matter put to rest. This out-of-court settlement was clearly only a small price to pay given what was at stake. It is obvious that the incumbent was already benefiting from being in the position and would stand to benefit a lot more in the future.

As alluded to above, the ‘big man’ status prevalent in most petroleum project area communities is ‘typically achieved rather than ascribed’ (Rivers 1999:2). The achieve-

ment of ‘big man’ status is becoming an alluring incentive for most men, both young and old, as a step towards taking control of the huge sums of resource rent available in the form of cash. Men in the project areas have been quick to realise that this new source of wealth would provide them the quickest, easiest and surest launching pad to achieving this status. As a consequence, men are jostling for leadership roles, which results in leadership tussles between the young and old, and between the well-educated, the semi-educated and the illiterate village ‘big men’. When land groups are hijacked by young, so-called educated ‘élite’ at the expense of village ‘big men’, this can result in the breakdown of traditional mechanisms of social control in the affected communities (Marru 2002).

Unlawful and unfair sharing of benefits.

The Department of Petroleum and Energy has received numerous complaints that ILG members have not been receiving their rightful dues in royalties or equity dividends. The onus for the equitable sharing of resource rents is on ILG leaders. However, the people who have been entrusted to act fairly on behalf of ILG members have often diverted resource rents to people who are either not members of ILGs or are members but have been allocated more than their share of the rent. This behaviour causes enormous problems for the department and adds to the transaction costs of all parties involved. Complaints of such nature are common but often peak just after royalties or equity dividends have been distributed to ILG recipients.

The unfair sharing of benefits may be carried out by ILG leaders to enable royalty or equity monies to be diverted into their accounts. At other times, the leaders condone such activities to allow their relatives or friends to benefit from someone else’s rightful dues. On other occasions ILG leaders allow outsiders to share in the benefits of their people in exchange for certain favours. This



kind of behaviour was experienced with several Moran Project ILGs. During the period of the 2002 national elections, an ILG variation exercise was being carried out in the Moran Project area. Several ILG leaders met with a candidate for one of the open electorates in the area and promised him participation in their ILG benefits. He agreed and was included as an ILG beneficiary in a number of ILGs. We can only speculate that this was done by ILG leaders in the hope that the candidate would win the election and employ his political clout and connections to reciprocate, in any way fitting, when his assistance was required.

These problems have caused a great deal of frustration among landowners, leading to the fragmentation of existing ILGs and proliferation of new ones. However, in some instances, there is intentional incorporation of 'ghost' groups. These 'ghost' ILGs are manufactured by ILG members intent on acquiring additional benefits. In other cases, the problem of unequal distribution of benefits has arisen when ILG leaders have initially decided on a sharing formula in verbal consultation with their group members, but have had the formula changed when recording it on paper, or are able to manipulate authorities to alter the sharing ratio.

Complaints about leaders misusing ILG funds. Complaints about leaders misusing ILG funds are on the rise. The problem is manifest where ILG leaders and members move away from project areas to take up residence, say in Port Moresby, where they have to rely solely on income from petroleum benefits. The pressures of living comfortably in Port Moresby take their toll on their share of benefits, hence 'topping' up from their members' shares assists them in maintaining their new lifestyles.

In the villages, ILG leaders use their constituents' monies to settle outstanding debts, incurred as a consequence of their taking on new wives and having to pay

bridal wealth, or having pigs slaughtered on 'credit' for bridal or mortuary feasts or traditional compensation purposes. Village leaders or 'big men' usually have a procession of followers whom they have to appease every now and then. Such a burden usually taxes heavily on the leader's resources, leading him to siphon off money to meet his obligations.

In these instances, the initial misapplication of funds is obscure but gradually becomes noticeable as greater amounts of money are diverted for personal use. This compels ordinary members to complain about the non-receipt of their rightful dues. Often, as a result, ILG members are forced to request the Department of Petroleum and Energy to arrange for their benefits to be paid separately, outside the auspices of their own ILGs.

A classic example of leaders misusing ILG funds occurred in April 1999, when Foe leaders managed to withdraw K845,000 from the Foe Future Generation Term Deposit Account with Bank South Pacific. To date, the use of this money has never been properly accounted for.

Lack of representation and responsibility of ILG leaders. Complaints have been registered with the Department of Petroleum and Energy concerning poor representation of ILG members by their leaders. It appears that rather than acting in the interests of their group, many leaders tend to act myopically or egocentrically for short-term personal gains at the expense of long-term group gains. It appears that such behaviour is a 'mean streak of nature', where rational individuals will not act in the best interests of the group but would rather further their own interests (Ostrom 1990:6). The end result of this behaviour is usually 'élite' capture, where the élite of a community use their power, influence and connections to control the benefits accruing to ordinary ILG members. The lack of responsibility by ILG leaders has resulted in civil proceedings being instituted by disgruntled ILG members



against their leaders, rather than having the matter resolved traditionally or by some alternative dispute resolution procedures. The results of such actions are an increase in transaction costs and emotional bitterness amongst once close friends, at the expense of finding lasting resolutions and maintaining amicable relationships.

An example of the lack of representation was the leadership rivalry between two factions of the Foe people attempting to have their separate associations recognised by government as the legitimate political mouthpiece of the Foe people. The feud continued for many years with both groups aggressively lobbying national and provincial politicians to muster support for their cause. Both groups took out full-page paid advertisements in Papua New Guinea's two daily newspapers accusing each other of malfeasance and impropriety. They went to the extent of taking out court orders and counter court orders against each other. In the process, ordinary Foe villagers were not adequately represented and so missed out on a lot of spin-off opportunities associated with petroleum development in the Kutubu Project.

Lack of accountability and transparency. Given the above scenarios where the ILG leaders appear to be in the business of gratifying themselves at the expense of their members, one can conclude that it will be in the best interest of the leaders to keep vital information and statistics to themselves. If information is a means towards amassing power and wealth, then obviously it has to be jealously guarded by those who want to use it for their own ends. As such, the failure to provide financial reports to ILG members, the failure to communicate and convey pertinent government information to ILGs, the poor or misrepresentation of ILG wishes to government and companies, the misuse of ILG monies, and the lack of ILG general meetings must be seen as examples of a lack of accountability and transparency on the part of ILG leaders towards their constituents.

Most of the problems discussed in the earlier sections can also be categorised under lack of transparency and accountability simply because they do not occur in a vacuum. If, on the other hand, transparency were a practising virtue of ILG leaders, such problems would be held in check, allowing efficacious remedies to be found for them.

A prime example of lack of transparency and accountability is the case where several Upper Fasu ILG leaders, who were appointed as directors of their umbrella business corporation, ventured into civil works contracts in the Kutubu oil field. After only a few years, these leaders conspired with the management of the company to award themselves hefty salaries, perks and privileges worth a couple of hundred thousand kina per annum. This was done without the consent of their ILG members, the financial shareholders of the corporation, who were mostly illiterate villagers.

Inability of ILGs to solve their problems internally. Almost all ILGs have been unable to sort out their differences internally. It is a requirement under the Land Groups Incorporation Act that all ILGs must have a constitution and a dispute settlement committee, which should invoke provisions under the Land Dispute Settlement Act as well as the Land Groups Incorporation Act. However, it appears that the dispute settlement committees that have been formed are only 'window dressing', actually non-existent on the ground, or not been put into motion, or simply lacking the will to perform.

In lieu of having disputes resolved customarily or by consensus in a true 'Melanesian' fashion, disputing parties have been taking their issues to court. Land dispute issues have been registered with local land courts while other civil matters and issues have been heard in District Courts and even the National Court. This creates further transactions costs where ILG monies have been used to hire consultants for all sorts of advice as well as lawyers to take up legal



issues on behalf of ILGs. Thus, monies that were meant for ILG members are diverted to pay high consultants' fees and legal bills.

Political alliances as a means of facilitating rent seeking. There have been insinuations made to the Department of Petroleum and Energy by ILG members against their leaders whom they accuse of being too 'close' to provincial and national politicians. Ordinary ILG members fear that these alliances may be detrimental to the financial stability of their ILGs and tend to treat the alliances with suspicion. Moreover, such alliances come at a price, which is paid from ILG funds, and the benefits are not enjoyed by ILG members but rather by a few individuals who claim to represent ILGs as leaders.

It is believed that alliances forged between ILG leaders and politicians are used by the ILG leaders to intimidate or compel the department to listen to their demands. The ILG leaders pride themselves on their liaisons with politicians, as such relationships cause them to feel empowered and important in the eyes of others. When such alliances are firmed up, ILG leaders are able to manipulate government processes to siphon off monies meant for ILGs for personal purposes. Hence, the political alliances are employed by ILG leaders to facilitate rent seeking and 'elite' capture. There is some reciprocity in these arrangements in that politicians use ILG leaders to divert ILG funds for their personal or political use, such as financial assistance for election campaigns. ILG leaders who enjoy their day in the 'political spotlight' often divert ILG monies to fund political activities, in the hope that their gesture will be reciprocated.

Bribery and corruption within ILGs. Bribery has become a normal transaction between ILG leaders and politicians. Depending on the nature of the alliance, everyone within the alliance becomes the recipient of bribes or the giver of bribes at some point. Baland and Francois (2000) point out that rent seeking is

exacerbated when the most talented, respected and knowledgeable people in society engage in such behaviour, especially through the political process, and over time it becomes the norm in the political process and government behaviour. Generally, such practices are more prevalent in developing countries than developed ones, simply because institutions in developing countries are relatively less effective (Lopez and Mitra 2000; Baland and Francois 2000).

There are many examples of bribery and corruption involving ILGs, however most of the evidence is anecdotal. Whilst most of these activities do not involve the embezzlement of ILG funds, there have been instances where project area leaders have applied their political and financial clout to sway government procedures in their favour. These occur, for example, when government officers transfer special support grants meant for the project area infrastructure development into legitimate development authority accounts, which landowner leaders control. Often the money ends up not being used for development purposes at all. For instance, millions of kina have been paid to the Kutubu Development Authority over the years, however, there is very little tangible infrastructure development in evidence.

Another example is the case where Foe leaders managed to convince the Treasury Department in 1999 to pay K2.6 million in special support grants funds to the Kutubu Development Authority for local infrastructure projects. However, an audit undertaken by government has shown that much of this money has never been translated into tangible outcomes. This allegation was contained in a full-page advertisement in *The National*, 4 August 2000, placed by a rival to the Foe group that formed the management group within the Kutubu Development Authority (Lea 2002:88).

In the same advertisement, the same Foe leaders in Kutubu were accused of acquiring



from MRDC, in a highly suspicious manner, an advance of K1.5 million of Foe landowners' future dividends. It is further alleged that from that total, K850,000 was used to purchase a motel, which was believed to be valued at only K500,000 at the time. It was also claimed that the balance of the K1.5 million has not been acquitted to date (Lea 2002:88).

On a smaller scale but equally bad is the blatant lack of honesty and personal misuse of ILG funds and assets by ILG leaders and ILG business directors whilst in Port Moresby for ILG business, or even worse, on the pretext of undertaking ILG business.

Failed landowner business enterprises. Corrupt practices and rent seeking have resulted in numerous failed business activities undertaken by landowners in the project areas. Business directors disappear from the project areas and slip into Port Moresby to 'partake of the good life' where they lavishly spend meagre company funds on hire cars, hotels, fine wine, and women. At other times, the company directors award themselves extravagant salaries for doing absolutely nothing. Company directors who have little knowledge of how a successful business enterprise is run demand company vehicles and use company fuel and maintenance services without paying for them. Frequently, the end result is the failure of the landowner business. The project operator's business development officers as well as government officers are often tormented by landowners with requests for loans and business support grants, or some form of financial guarantee, when they realise that their businesses are on the verge of financial collapse or are deemed to have failed.

Principal-agent problems

Marru (2002) has argued that the problems with ILGs largely derive from institutional failure that gives rise to principal-agent problems. As understood by economists,

institutions are the agreed 'rules of society' or incentives, which provide structure to human activity through constraining arbitrary and opportunistic behaviour, and are enforced by sanctions. Being human creations, institutions are a product of existing knowledge and, therefore, are revised, discarded and developed as knowledge evolves. Institutions can be imposed formally by a top-down approach or by market forces or informally in a bottom-up manner through an adaptive or iterative process of feedback and adjustments.

Given their approval through legislation, the ILGs can be thought of as formal institutions that have been given the job of distributing resource rents from development projects. Institutional failure may arise from inappropriateness in design or from the lack of enforcement of the 'rules' of the institution. Marru (2002) has argued that the manner in which land groups are incorporated does not allow for customary mechanisms for distribution. Thus, there appears to be a conflict between externally imposed and local institutions. Lea (2002) has more fundamental criticisms of ILGs and argues that they are invalid and cannot be effective. This argument is not taken up in this article. The focus here is on the fact that ILGs give rise to considerable principal-agent problems and on the questions of whether and how the agency problems may be substantially reduced and ILGs carry out the task of resource rent distribution without the extraordinary problems described above.

A principal-agent problem arises when there are conflicting interests between a principal, for example, an employer, constituents in an electorate, or shareholders in a firm, and an agent, for example, an employee, a politician, or a contractor. The dilemma arises when the agent has informational advantage (asymmetric information) and differing interests to those of the principal and acts in a way that promotes the agent's interests over the



principal's. In short, an agency problem occurs when an agent does not act in the best interests of the principal but rather in furthering their own interests (Grant and Karni 2002). ILG leaders and leaders of landowner associations are privileged trustees (agents) of the resource rents and responsible for distributing them to the principals, that is, the landowners. However, the trustees are clearly not acting in the best interests of their principals.

Discussion and conclusions

Principal-agent problems and elite capture are major concerns in relation to ILGs in the petroleum sector in Papua New Guinea. A number of observers have flagged these concerns, including Weiner (1998), Kalinoe (2000), Lea (2002) and Marru (2002). Internal leadership struggles and manipulation of ILGs for one's own or relatives' benefit, bribery and corruption amongst ILGs, and political influence and interference are some of the problems currently confronting ILGs. The pursuit of self-interest, involving conflicts of interest, is clearly a common problem within the ILGs (Feeny, Hanna and McEvoy 1996; Osborne 2000; Ostrom 2002).

Agency problems are inherent in all arrangements where an agent is acting on behalf of others. What should the government be doing to address these problems in ILGs in the petroleum sector, or in other sectors for that matter? The pervasiveness of agency problems in the activities of ILGs as presently established suggests that they will not be easy to resolve. Remuneration of the agents is usually an area that is given a great deal of attention in trying to reduce agency problems. However, there seems to be little that could be done with respect to the payments to leaders of groups that would entice them to give up the huge benefits they are deriving from the forms of inappropriate behaviour described above.

Principal-agent problems mainly arise from the fact that government monitoring and enforcement capacities are inadequate and ineffective. One of the outcomes of the agency problems and one of the principal ways in which benefits have been unfairly distributed has been the fragmentation and proliferation of ILGs. So long as ILGs, whether in the petroleum sector or in other sectors, are not monitored appropriately and sanctions not enforced against those undertaking illegal activities, principal-agent problems will be widespread.

There is obviously an urgent need for more and better checks and balances to be integrated into the process to make ILG leaders more accountable and transparent in their actions. Looking over the problems with ILGs described above, the main form of control of the agency problems would seem to be improved monitoring of the landowner leaders' behaviour on the part of the government and strict enforcement of sanctions against those who perform illegal acts. This will mean the government devoting additional resources to this oversight activity. Marru (2002) notes that the ILG desk in the Registrar of Title's office is short of staff and physical resources. There is clearly a lack of transparency in ILG activities. Just as with public companies, it is therefore probably a good idea to force the ILGs to report publicly on a regular basis. As noted above, landowners are often not well educated and therefore the government has an obligation to see that their affairs are conducted appropriately and that the actions of the ILG directors are explained to them. It may also be useful to include the Ombudsman as part of the oversight function.

Alternatively, a more transparent, effective and efficient form of distribution could be set up whereby benefits accruing to ordinary project area landowners can be distributed to them individually instead of being channelled through ILGs. This is the form of distribution of oil revenues in Alaska.



Each quarter, all residents of Alaska are paid an equal amount from the revenues generated from the sale of oil. If such a system were implemented, it would ensure that individual beneficiaries would become more prominent than in the current system where the focus is on ILGs and their leaders. This appears to be a simpler and more equitable process than is presently the case with ILGs.

Direct payments to individual project area beneficiaries will undoubtedly take away opportunities that currently exist for principal-agent problems and their associated transactions costs to flourish. Another option available to the government is to channel all resource rents into landowner businesses in which landowners are appropriated equity shares from which they can receive dividends from declared profits. But this option also provides opportunities for principal-agent problems, as the decisions about which businesses to invest in and the appointment of managers of the businesses will give rise to conflicts of interest.

The government could also consider allocating all benefits accruing from the Kutubu Project to social and infrastructure developments in the project areas in lieu of direct cash handouts, as happens with oil revenues in the Canadian province of Ontario. This alternative requires political will for a change that may be difficult, given the current practice of 'cash handouts' which the people are accustomed to and which is breeding a handout mentality amongst the project area people. It also assumes that government's use of the funds would be more productive than allowing individuals to make decisions about how the money should be spent.

A better option would be to model the direct distribution of royalties on the way in which the Future Generation Funds are managed. That is, rather than the distribution being managed by landowners, this function could be performed by an independent

agency. Future Generation Funds are managed by the MRDC under advice from a Board of Directors. There have been some allegations of landowner leaders gaining illegitimate access to funds held by the MRDC. Obviously, protective mechanisms would have to be developed against this kind of behaviour.

The problems addressed in this paper illustrate the poor appreciation in Papua New Guinea of the important role of trusteeship and the conflicts of interest that arise from appointments to leadership positions. Trusteeship of public funds is an important position and the function should be undertaken with the highest degree of integrity. Ideally, trustees of public monies should have no personal interest in those funds, otherwise there is a conflict of interest. Clearly, it is difficult in a country such as Papua New Guinea with its small population and very small number of people who have the necessary financial skills for effective management of trust funds. Therefore, it seems that an appropriate balance should be sought between appointing outside experts and local people to reflect the knowledge and interests of the people.

Notes

- ¹ Resource rents comprise the royalties from the sale of petroleum and equity dividends paid to petroleum project area landowners, as well as indirect landowner benefits such as physical and social infrastructure derived from the project (roads, schools, and medical centres).
- ² The Fasu and Foe are the two major ethnic tribes residing within the Kutubu Project area (PDL 2).
- ³ MRDC is a state-owned company entrusted with the holding of the equity interests in mining and petroleum projects of landowner companies.



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