Policy dialogue

Managing natural resource revenues in Papua New Guinea

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There is a need for Papua New Guineans to thoroughly discuss the management of the government's share of the mineral, oil, and gas revenues.

Papua New Guinea has experienced two major mining booms since independence. As noted in the 2009 *Pacific Economic Bulletin's* economic survey of the PNG economy, the first of these booms in the early 1990s was managed very poorly, with government expenditure greatly exceeding revenues. This resulted in a large increase in public debt and the devaluation and eventual floating of the kina.

The recent commodity boom has been managed more effectively, with the paying down of public debt and the setting aside in trust funds of some of the windfall revenues for future expenditure on long-overdue refurbishment of important public infrastructure and development of essential services.

Unfortunately, there has been also sharply increased recurrent expenditure; and currently there is some doubt about how well the windfall revenues set aside in trust funds have subsequently been managed.

Whether the setting aside of the windfall revenues in various designated trust funds was a good idea or not, it was an *ad hoc* reaction to the receipt of the commodity boom revenues.

It is certain that Papua New Guinea will continue to experience commodity booms and slumps because of the high variability of global primary commodity prices, and when the LNG project comes on-line, the PNG government's share of resource revenue flows and fluctuations will increase significantly.

Therefore, it is very important for the people of PNG to have an in-depth discussion about how future national government resource revenues can be managed on a consistent, effective basis.

Much of the past discussion of the management of the government's mining, oil, and gas revenues has been concerned with the holding of the inflows in funds and the functioning of these funds as mechanisms for the stabilisation of flows into the government budget, for sterilising the impact of the foreign exchange inflows on the country's exchange rate and other

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export and import-competing industries, and as a way of saving some, or all, of the revenues for future use.

PNG's Mineral Revenue Stabilisation Fund (MRSF) was intended to be used in this way but was unable to achieve any of these objectives.

However, while good models for the design of funds to hold resource revenues have been developed, such as the use of independent trustees as in the case of the Ok Tedi Development Foundation and the Timor-Leste Petroleum Fund (which is based on Norway's State Petroleum Fund), it is important to note that the primary management problem has been with the effective expenditure of the resource revenues.

It is one thing to have effective control over the revenues going into the trust fund, but it is quite another thing to spend the money effectively. Indeed, the latter has been Papua New Guinea's main problem.

Therefore, a major issue for discussion in Papua New Guinea is whether institutional arrangements can be devised which will ensure that the resource revenues collected by the government in the future will be spent more effectively.

It is not feasible that the revenues be locked away for future use, such as in Norway where the State Petroleum Fund is to be used to provide incomes for retirees.

Papua New Guinea has a desperate need to see the resource revenues go towards the development of its physical and human capital (education).

However, if the past is any guide, one cannot be optimistic that government expenditure of these revenues will deliver this result.

The 2010 PNG economic survey lists the problems that have been experienced in the past in managing resource windfalls and raises questions about the relative roles of stabilisation, sterilisation, and savings in any mechanism that is established, and the challenges faced in realising the set objectives.

However, these are secondary objectives; the major problem faced is how to ensure effective use of the resource revenues that are received.

Can institutions or mechanisms be established which will ensure that there is much better government use of the revenue inflows than over the past 30 years?

The management of resource revenues in developing countries — and in some high-income countries — has not been a happy one, with a few exceptions. Waste, corruption, macroeconomic instability, civil conflict, and distortion of political processes have widely accompanied the flows of these revenues.

A recent Working Paper from the Center for Global Development has argued that the reason Botswana (Moss and Young 2009) — the country with the highest per capita growth rate in the world between 1965 and 1998 — has managed to use the large revenues from its diamond exports to underpin this growth is because there is a strong political constituency (the cattle industry) supporting the effective use of these revenues.

Chile, Indonesia, and Malaysia are also given as examples of countries where good use has been made of mineral and oil revenues. In these three cases the countries had "strong governments" that had a keen interest in the widespread development of the economy and were able to resist narrow, vested interests.

The other interesting cases that the Working Paper raises are Alaska and Norway. The authors argue that, in these cases, the oil and gas revenues are well-managed because there are also strong political constituencies protecting their interests.

In Norway's case the political constituency is the increasing number of retirees depending on the good management of the Fund.

In Alaska's case, a Permanent Fund was set up to collect revenues from oil exports. The Fund must be invested outside Alaska and its purpose can only be changed by changing the State's Constitution.

The earnings from the Permanent Fund's investments are distributed quarterly and on an equal basis to all Alaskan citizens.

Thus, all citizens have an interest in protecting the Fund, and it is said that it would be "political suicide" for any politician to suggest changes in the management of the Fund.

The many examples of developing countries that have not been able to manage resource revenues effectively are seen as not having a political constituency with an interest in protecting the revenues from corruption, waste, and so on.

Papua New Guinea does not appear to have such a constituency.

Is it possible that PNG can develop such a constituency?

This question must be answered in the affirmative before it can be assumed that refinements of the way in which resource revenues are made available to the government will be viable — such as those suggested in the World Bank's draft discussion paper on 'Managing Resource-Induced Volatility in Papua New Guinea' (World Bank, 2010).

The implementation of the Alaskan model in Papua New Guinea would develop a widespread constituency for the good management of the invested funds.

It should also develop a stronger public interest in government expenditure, as the public would be paying taxes in the form of value-added tax from its expenditure of the dividends.

Where the public has little relationship with government revenues, as with resource revenues paid directly to the government, there is little insistence on public accountability. From cross-country analysis, a tax-paying public can be expected to have a closer interest in how its taxes are used.

It is also quite likely that the distribution of such funds to all Papua New Guineans would lead to increased agricultural and rural productivity, which would have flow-on benefits to the whole economy, as it did in the fastgrowing, land-abundant East Asian economies such as Malaysia, Thailand, Indonesia, and Vietnam .

The flow of dividends to the bulk of the Papua New Guinean population in the rural areas would provide them with access to capital that they currently do not have, and would give them the capital to develop their farming and other informal, cash-earning activities.

Early, rapid agricultural productivity growth in countries such as Malaysia, Thailand, and Indonesia laid the basis for their sustained, broad-based, economic growth.

Would the Alaskan model be technically possible in Papua New Guinea?

Given the extensive coverage of mobile phones in Papua New Guinea and the developing use of mobile phone banking, the improved registration of births and deaths, and, very significantly, the recently amended ILG Act, which provides the grassroots with a base for updating details of all individuals in a social unit such as a clan, the distribution of dividends from an invested resources fund looks to be more and more feasible.

It could also lead to improved information being collected from the Census, and improved electoral information.

Would such a scheme be politically possible? Just as with any major reform

— including developing institutions to achieve improved government expenditure of windfall mining revenues — a political "champion" would be needed to bring it about.

The Center for Global Development paper suggests that the Alaskan model provides a model worthy of consideration for Ghana, which has recently discovered oil and will soon have large inflows of oil revenues.

The Alaskan model is also worth consideration by Papua New Guinea. It is important to note that the payment of Fund dividends to all Alaskans has had strong benefits for the economy, with people saving a large proportion of the quarterly payments, which feeds into investment and economic growth.

This behaviour contrasts significantly with the widespread behaviour of developing countries governments' use of resource revenues, which are often used for unsustainable recurrent expenditures.

Unfortunately, unsustainable increases in recurrent expenditures have occurred in Papua New Guinea during its two commodity booms since independence.

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