

Papua New Guinea: Benefiting or losing out in commodity booms?

By Paul Barker
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This is a guest post by Paul Barker of the Institute of National Affairs in Papua New Guinea.

Papua New Guinea is experiencing a boom associated with LNG development and record prices for most of its mineral and agricultural products. One might expect the country's population to be thriving from this, with the benefits extending right out to rural communities. However, whilst some individuals and businesses are certainly doing nicely from prevailing conditions, including owners of urban real estate, most of the population (and many businesses) are either left out, or unable to take advantage of current or forthcoming opportunities, or in some cases worse off (by growing costs, shortages and bottlenecks). The benefits are therefore localised in a few main centres, businesses and households, whilst even the formal sector employment growth (e.g. construction) has dropped away since its peak in 2008.

The weak link is a failing State with its severely underperforming institutions, which struggle from poor leadership, poor coordination, low morale, corruption and in many cases inadequate resources for the tasks they face, particularly after years of neglect and poor oversight, and now with greater competition from the private sector for certain key skills, from engineers to doctors, (with even the latter being hired in numbers -for a premium -by PNG LNG). This incapacity of the State severely undermines the extension of development opportunities and benefits through the economy, across the provinces and the community, notably by failure to provide critical public goods, notably maintaining vital access roads and other infrastructure and services, including addressing burgeoning crime, whilst often diverting effort and resources into marginal or inappropriate activities. This must be addressed now, or LNG and other major resource development will indeed be more of a curse than a benefit.

Unfortunately, we will not see improvements in government performance (despite the efforts of many dedicated individuals within the public sector) until the public stops kowtowing to non-performing leaders, stands up and holds government and individual leaders accountable for the use of public funds, (including by State enterprises), and stops seeing government and politicians as the provider of jobs and cash handouts to wantoks and political cronies, or demanding unjustified compensation or out of court settlements.

Unfortunately, years without routine services and with very restricted education opportunities, has left much of the population disempowered, unaware of the role of government and what they should expect and demand of it. Back in the late 1970s much of population demanded the most skilled people available fill key jobs, to ensure they obtained the best available services, such as schools for their children. Yet we now see the best candidates for so many top public sector positions sidelined and 'yes-men', incompetents or cronies appointed, and, if the best are appointed, they're given inadequate support to perform effectively.

The current high commodity prices offer a 'windfall' for producers and, indirectly, the State. They provide increased income to oil, mining and logging companies, as well as producers of export crops like palm oil, coffee, cocoa and rubber, but also those supplying fruit and vegetable and sugar for the domestic market, but unfortunately many producers cannot take advantage of the opportunities, owing to impassable roads and inadequate marketing infrastructure for perishable goods, produce theft and uncontrolled pests (like CPB); instead, large numbers have drifted to towns in the absence of services and perceived opportunities in rural areas and in search of jobs, schools and other facilities in towns. However, finding limited formal jobs is hard, particularly for the unskilled victims of PNG's inadequate primary and technical education, whilst the informal economy has been restrained by limited support, at least until a recent positive policy shift. Urban consumers, particularly those on low or fixed incomes, but also many businesses, are suffering from the booming housing and rental prices, and the burgeoning fuel and food prices.

The high commodity prices enable the State to collect extra revenue, notably from company and household income tax, plus higher export duties on logs. Earnings from extractive industries flow substantially offshore (as will LNG income in future), to service debt and reward shareholders, but their main value to PNG (and the provinces) is providing the backbone of the country's tax revenue, particularly in years of high mineral prices, to fund public goods and services for the rest of the population (e.g. 36% of total revenue in 2006 from mining/petroleum taxes alone). So the value of these industries to PNG depends to a great extent upon how effectively government uses this revenue. This effectiveness will remain critical in future when LNG revenue is expected to commence, particularly towards the end of this decade. LNG will provide few jobs directly (500-700, once production commences in 2014, assuming current delays are overcome), so its main benefit must be whether or not it can empower the population and other industries, to generate jobs and opportunities. Earnings from agriculture are, in many ways, more valuable, with less immediate leakage, and with income flowing directly to millions of producers and others

involved in the industry across the country (in processing, transport etc), although contributing less in tax revenue.

The current market situation entails only a 'windfall', as the increased earnings result from buoyant external market factors, rather than any effective policy measures in PNG, or increased production, which in agriculture has been lagging population growth. Indeed for most of these products supply within PNG has remained static or in some cases even fallen, despite the high prices, either because there are declining known reserves (as with Kutubu oil) or various restraints have handicapped local producers (notably farmers) from responding to improved market opportunities to export or substitute imports, notably poor transport infrastructure and services and crime. The current high commodity prices result largely from strong demand from East and South Asia for the raw materials and other products PNG produces, combined with speculative forces and supply restraints in major producing areas - e.g. uncertainty and conflict in the Libya/Middle East, Ivory Coast for cocoa and staple crop failures in 2010 in several major producing countries.

Hopefully, rural households will benefit from the strong commodity prices and decide to invest in future production increases, notably through more intensive management, with many living in the towns inclined to return to rural areas to harvest and plant agricultural crops. Unfortunately, evidence over recent decades has found that, whilst high prices provide producers improved incomes, most crops, except oil palm (and briefly crops like vanilla), have not increased in output over recent decades, as farmers haven't seen adequate returns from investing their time, effort and land into extra production. Oil palm has been different, being managed on an agro-nucleus enterprise basis, with a major investor providing many of the marketing and support services to the smallholder producers, and therefore less dependence upon weak State entities, although even in agriculture government has severely handicapped producers, e.g. with the failure to restore roads in Oro following the 2007 floods.

In PNG many companies provide support functions to local communities far beyond normal business responsibilities in other countries, largely because of the failure of government, including local government. They need to do this to maintain the trust and support of the local community. It is an added cost of doing business in PNG (along with many other costs, such as back-up power generation etc.) and clearly some companies are better placed to do this than others. Some other businesses, by contrast, take this responsibility far less seriously, providing minimal support and even by-passing tax and other formal obligations. To a large extent PNG survives, owing principally to the resilience of its self-dependent population and the efforts of churches, NGOs, responsible businesses, plus many committed

public servants and a few leaders who make a major effort to ensure services are delivered despite the breakdown of government systems, and the imbalanced allocation of funds for services.

Yet, the country should not be struggling with Asia and the Pacific's worst social indicators (particularly atrocious maternal and child mortality rates, which show little sign of improving, if at all). PNG has adequate resources and revenue to provide reasonable public goods and services, across the country, and to enable farmers to be able to access markets and, for example, take advantage of current good market prices and see adequate prospects to invest for the future.

There'll be a few relatively lean years, and then an expected progressive build-up of revenue from LNG and other projects later this decade, if it's not all pre-committed for exorbitant expenditure and paying out often bogus claimants for compensation, out of court settlements and unrestrained corruption. If adequate action isn't taken now, there will be no wider benefit for the country as a whole from future LNG and other resource extraction, and only the costs and cries, of "if only we'd taken action to address governance sooner"! There will be costs, and inflationary pressures, including needing to pay more to retain key skills in critical public sector jobs (including engineers, medics, but also teachers and many other skilled workers, at least until the LNG construction phase is over).

So, if PNG is to benefit from the current strong commodity prices (and future LNG/mineral) and provide employment and income earning opportunities into the future, we (including government) need to:

- Restore accountable government, genuinely answerable to a more functioning Parliament and the population, removing discretionary powers of individual public officials (as with certain Land leases, Environmental Permits etc)
- Empower individuals and communities (through formal and civil awareness and education), right into rural areas, not only to secure opportunities for themselves, but also hold government, including local government and leaders more accountable (including through social auditing),
- Better target development plans and actual public expenditure to provide reliable and more balanced infrastructure and services across the provinces and districts; (if the current utterly inadequate recurrent funding, including for infrastructure maintenance and services in most provinces, continues so too will PNG's poor social indicators and failure to achieve MDGs, whilst the DSIP mechanism is inequitable, and a recipe for major wastage of public funds),
- Concentrate on basic infrastructure maintenance and upgrades, rather than

superfluous, exorbitant and unmanageable projects and management systems (including special administrative zones);

- Encourage private investment and competition in the provision of some public goods and potential commercial services, enabling more reliable and competitive provision (e.g. of power) and for government to focus public funds on core priorities
- Operate firmly within the annual Budget, especially within the pre-election period, and no (more) exclusive extra-budgetary borrowings and commitments for favoured electorates (e.g. Kokopo);
- Ensure a suitable balance between priority budgetary expenditure (including effective investment), debt servicing and 'savings' in future sovereign wealth fund(s); ensure SWG(s) have clear mandates and transparent governance mechanisms, (or they will be a liability rather than an asset to safeguard the wider – non-LNG- economy and the future).
- Address the public sector crisis, by right-sizing institutions to need (increased police, education and health numbers, but also targeted reductions), making public service conditions more competitive for essential staff being lost, less acting appointments and more rigorous and transparent selection of candidates, removal of corrupt and non-performing managers and replacement of bodies with more accountable mechanisms, such as DAL into an agricultural organisation reporting direct to PNG farmers,
- Strengthen formal oversight bodies (AG, OC, Finance Inspectors etc) and tackle major concentrations of apparent ongoing corruption and abuse (e.g. Lands, Police etc), including halting the disastrous ongoing land grab of millions of hectares of customary land (and forest resources) for 99 year leases to outside clients (maybe involving staff of Lands, DAL and other institutions)
- Introduce freedom of information and whistle-blowers' legislation, and make State agreements, transactions and receipts (including by SOEs and over extractive industries) and also leaders' assets and income publicly available (not for the Ombudsman's exclusive viewing);
- Remove bureaucratic restraint on legitimate business and encourage business to provide local employment and wider service contributions (e.g. training, health and possibly marketing support); develop market mechanisms for allocating and transferring titles, such as for alienated urban lands
- Enforce rules safeguarding opportunities for local employees and businesses in restricted categories
- Restore agricultural research and extension services, using successful public and

private models of service provision; the recent National Agricultural Development Plan was largely a waste of effort and major public funds, which ended up as an unaccountable, discretionary mechanism for handouts (in only very few cases to useful initiatives), but substantially to politically favoured or unproductive schemes, as with the wasteful funding for cattle. More transparent mechanisms for agricultural investment support, largely through loans, but also for research, development and innovation, and well-managed freight subsidies for remoter areas have been trialled and should be carefully applied, with clear guidelines and oversight.

The private sector is the engine of growth, but the State has a critical role to ensure that the benefits from development are equitable across the country and through the community. Growth in itself has limited value, unless it is sustainable and benefits retained within the community, which requires that the community is accessible, educated and trained to participate and drive the process. The recent experience of discreet deals, unaccountable government and ineffective public services has squeezed much of the population out from benefiting from current strong commodity prices and major development projects. Papua New Guineans should not be satisfied with being by-standers in a process of resource extraction to overseas (largely Asian) markets, but actively participate, steer and where necessary restrain the process, or renegotiate the arrangements. Recognition that the need for effective social protection schemes are also increasingly overdue in PNG's fast changing economic and social conditions, to support and empower the most disadvantaged in the community; especially some women and children.

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