Service Delivery and Resource Revenues in PNG

By Aaron Batten

This is a guest post by Aaron Batten.

The $US15 billion Exxon-Mobil Liquefied Natural Gas (LNG) project stands to be the largest resource project in PNG's history. Projections indicate that Government revenues accruing from the project could be as high as K2bn for the first ten years of production (2014-2024) and K3bn thereafter – representing a 22 per cent and 33 per cent increase to total revenue and grants in the 2011 Budget, respectively.

These revenues have the potential to greatly increase funding for social service delivery which, despite improvements over recent years, is still chronically inadequate for large parts of the population.

In some measure, a lack of service delivery is a result of weak public sector capacity to implement expenditure plans. It is also because real per capita funding for key items such as health, education and infrastructure persisted along a long term decline during the first 30 years of independence.

Since 2002, the Government has made significant progress in reversing this trend, but there is still much to be done. In 2010 real per capita expenditures for health and infrastructure were still 15 per cent and 30 per cent lower than in the early 1980s, respectively. Real education expenditure per capita was still only two thirds of what it was before huge cuts were made in the late 1990s.

What impact will LNG resources have on further increasing spending on key social service sectors such as health, education and infrastructure? Alternatively, how much of these resources might be used for other purposes such as replacing domestic revenue sources, lowering debt levels or financing general government consumption expenditure?

Analysis of historical PNG fiscal data reveals that past resource revenue inflows have had a weak impact on lifting central government expenditure in key service delivery sectors. Estimations show that on average, 2.5% of resource revenues have been spent on health and education whilst 5% have been allocated to infrastructure. The majority of remaining funds have been used to finance other general government expenditure as well as to lower domestic revenue collection.

If this past behaviour is continued then LNG revenues will have only a moderate impact on the funding directed towards these sectors – with real per capita health and education spending still remaining below 1980s levels.

Analysis also reveals that whilst aid revenues have had a bigger impact on increasing health, education and infrastructure spending than resource revenues, a rapidly growing population and the projected high growth in resource revenues, means donor aid will comprise an ever declining proportional share in PNG’s total resource envelope. Donors have an important role to play in providing targeted interventions that improve the efficiency of public expenditure and alleviate constraints to growth, but their ability to influence aggregate recurrent expenditures in social services will decline.

What implications do these findings have for managing the post-2014 revenue boom period?

1. Past behaviour is not necessarily a guide to future expenditure patterns. Government's change, as do their policy decisions and expenditure priorities. Growing real per capita expenditure for health, education and infrastructure in the post-2002 commodity boom period is a positive indication that more priority is being place on these activities than in the past.

2. Maximising the impact of resource revenues on service delivery must also be balanced against the broader challenge of managing the many well known risks that a resource project of this scale entails. Exchange appreciation and realignment of domestic production away from other tradable good sectors is the primary example.

3. PNG will also have to remain vigilant against the negative patterns of political and institutional behaviour that can be encouraged by large inflows of funds from resource extraction.

The Government has made good progress in managing these risks by creating a new Sovereign Wealth Fund (SWF) which will sterilise export earnings and promote a high level of accountability over fund usage.

The SWF also places a large focus on smoothing expenditure over time. This is particularly important for service delivery items such as health and education which are predominately recurrent in nature. Achieving a long term increase in funding to these sectors will thus be dependent on the ability of the SWF to provide consistent and predictable revenues which allow budgetary planners to expand recurrent expenditure items without fear of eroding fiscal sustainability.

However, as PNG's past experience with its former Mineral Resource Stabilisation Fund illustrates, without sufficient political commitment to long term expenditure management institutional structures such as this can be easily abused.

The most important factor in transforming resource revenues into improved long term development outcomes will therefore be the strengthening of domestic accountability mechanisms across all levels of government. At its core, these efforts should focus on continued strengthening of the domestic budget process, its oversight institutions and the integration of the Government's Strategic Plan (2010-2030) objectives into medium term expenditure planning.

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