14. The 'Resource Curse' and Governance: A Papua New Guinean perspective

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In discussing what has become known as 'the resource curse' one is confronted with two predominant views about the impacts of mineral and petroleum extraction on a national economy.

The conventional wisdom is that mineral resource developments can add value to the economy of a mineral-rich country. The principal effects of such developments are that they provide revenue to a host government through taxation and royalty payments, and they generate income and wealth for individuals and companies through the many financial transactions involved in the development process. In some sense this is certainly true for PNG, as the economy has always been buoyed by the mineral and petroleum sector. Thus, in a general sense, the traditional view maintains that 'mining plays an important role in the development process by converting mineral resources into a form of capital that contributes to a nation's output' (Davis et al. 2002: 6).

The other view, which has emerged in the past 20 years, is that it has a negative impact on the economy as it harms the traditional sources of exports and weakens the manufacturing base.[1] This view is based principally on studies carried out on several mineral-dependent economies,[2] particularly in the developing world. In some of these countries economic growth during this period has been negative. Those who subscribe to the view that resource development is a curse maintain that resource extraction has not contributed to sustainable increases in socioeconomic development in countries with rich mineral resources. At the extreme end, the argument is made that mining activity in poor countries will lead 'inexorably and inevitability to poor outcomes and growth' (Roe et al. 2004: 6). Such a situation would confirm the 'resource curse' view and might lead us to conclude that there should not be any mining, particularly in developing countries. A related issue that has contributed to the development of this view is the suggestion that resource development causes 'violence and civil wars' within countries (Shultz 2004: 34), leads to foreign intervention to protect multinational interests, and foreign intervention in internal affairs, or leads to 'social disintegration' within communities (Filer 1990: 88).

While poor economic performance has undoubtedly been the experience in some situations, recent empirical case studies have shown that while this might be true in some countries it is not the case in others (Roe, et al. 2004; DiJohn 2002). The obvious question is: why is this so?

In discussing this question, I shall draw on the two case studies of the Porgera and Ok Tedi mines, which operate in the highlands of PNG, and will examine their contributions to the benefit streams that accrue to governments, in particular, and, to a lesser extent, landowners and communities.

In the context of PNG, direct benefits of mining and petroleum are significant indeed. In the past decade, this sector represented more than 70 per cent of total PNG exports, more than 30 per cent of total government revenues and contributed about 25 per cent of GDP. In 2004 alone, the combined mineral and petroleum sector made up more than 73 per cent of total merchandise exports. That means for every kina of export revenue, 73 toea came from this sector. The mineral sector itself accounted for more than 53 per cent of total exports in 2004. From 1989 to 2004, the Porgera mine produced more than 13 million ounces of gold, worth more than K8.5 billion in export value. In 2004 the gold and silver from Porgera made up 16.4 per cent of the total exports from PNG. These contributions are matched by public revenue benefits. In 2004, the National Government received K170.4 million in taxes and duties from Porgera and, since production started in 1989, it has received more than K1.1 billion in taxes (corporate and income) and customs duties.

With respect to mineral royalties, which in the case of Porgera are granted directly to provincial and local institutions, since 1989, Porgera landowners and the Enga Provincial Government have received K157 million. This went to the Provincial Government (50 per cent), Porgera Development Authority (5 per cent), Special Mining Lease landowners (15 per cent), Children's Trust Fund (10 per cent), Porgera Landowners' Association (12 per cent) and Young Adults (8 per cent). Between 1989 and 2004, Porgera spent more than K51 million on employee education. Porgera also spent more than K10 million to sponsor more than 500 students (non-employees) to schools, colleges and universities during the period 1989-2004.

The case of the Ok Tedi mine paints a similar picture. During the period 1982-2004 the National Government received almost K1.4 billion from the Ok Tedi Mining Lease (OTML) in taxes and duties (corporate and income tax, customs duties). From 1982 to 2004, OTML paid K238 million in royalties and K246 million in dividends and spent more than K44 million on employee education and training.

What I have described above supports the traditional view that mineral deposits are assets and part of a country's natural capital. The argument continues that the more capital and natural wealth a country possesses and extracts in a sustainable manner, the richer and better off it will be. The extraction or capital conversion of a country's natural assets keeps the economy buoyant and provides the necessary public and private revenue to support services and further socioeconomic advancement.

In PNG, this sector is responsible for more than 70 per cent of the value of merchandise exports. Mining is the means through which dormant mineral wealth in the ground can be translated into public goods such as schools and hospitals and productive assets such as roads, bridges and ports. Further, the sector produces enhanced human capital in the form of new skills that in turn can facilitate economic development in other sectors of the economy. Therefore mineral development is crucial to the development of a country like PNG. Mineral resources are part of the nation's realisable capital and the revenues from them can and are being used in the improvement of other types of capital, including physical, human, knowledge and institutional forms. So, according to the traditional view, mining, like other economic activities, plays an important role in the development process and can convert 'a mineral resource in the ground into sustainable improvements in people's lives' (Togolo 1999: 597).

How then should we understand the critical view of mining that has emerged in the past 20 years, which argues that there is no positive correlation between resource extraction and economic development? Some studies have suggested that countries where mining is important have not progressed as rapidly as countries where there is no mining. They would argue that this would be true for PNG and might well extend the argument to suggest that there should be no mineral development because it has a negative impact on economic development.

The 'resource curse'

This view is articulated in the term 'Dutch disease' or the 'resource curse'. In brief, this view says that during a resource boom wages rise as the sector competes for scarce skilled labour and draws resources away from other sectors. As well, it is contended that an increase in mineral exports brings about the appreciation of the local currency, which in turn makes it difficult for agricultural exports and the manufacturing sector to compete internationally. When the mineral boom is over the country's traditional sources of exports could well have been destroyed, unable to be sustained in a high exchange rate environment.

Certainly from its macro-economic performance this seems to be true for PNG. Using the year 2000 as a base, the real exchange rate (PNGK/$US) was generally high during the period between 1980 and 1998 (Roe, et al. 2004: 55). Apart from the influence of the mining industry on the local currency, PNG's own 'Hard Kina' policy before 1994 was thought to be a sound macro-economic tool of stabilisation. In fact, it was highly distortive and, in the context of this discussion, was responsible for inflaming the 'resource curse'. It was a disincentive to the agricultural and manufacturing sectors by making them less competitive in the global market. At the same time, it increased the domestic cost of the mining industry. Foreign reserves fell to almost zero and the country was forced to float the currency in October 1994. This policy change is bearing fruit, though slowly. From 1995 to 2004, during the period of massive currency devaluation, GDP growth remained erratic and there were three consecutive years of negative growth from 2000 to 2002, a period in which mineral prices were depressed and oil prices were reasonable.

Additionally, the resource curse view might argue, in the context of PNG, that resource extraction (mineral, oil and gas) creates a handout mentality among a few wealthy rent-seeking landowners, who might have no idea about sustainability, creating expectations that are well beyond the reach of ordinary villagers. Rent-seeking behaviour encourages 'unearned' income to be wasted on consumption rather than investment and can become an excuse for poor governance (Shultz 2004: 37).

Let us look, however, at what has happened in the past and more recently to countries with large mineral resources. Many countries, such as Britain and Germany, took advantage of their mineral endowments and used them to build their productive industrial base for long-term economic growth. The USA, Australia, Canada, South Africa, Botswana, Indonesia and Chile are examples of countries that have done well by converting revenues from the development of their mineral and petroleum resources into further economic development. Conversely, there are countries such as Zambia, Sierra Leone and PNG, which have not done so well with wealth from minerals and other resources. It is my belief that the assertion that mineral extraction is responsible for negative impacts on the national economy is overly simplistic and ignores other contributing socioeconomic factors and governance challenges. If developing countries such as PNG are struggling to minimise poverty, discouraging mining where it promotes the goals of poverty reduction and long-term growth is counterproductive, economically irresponsible and clearly not sensible.

What are the reasons why mineral extraction (or for that matter any resource development) is able to promote economic development in some countries and not in others? Why does it work, for example, in Botswana but not in Zambia? What are the factors that have allowed some countries to maximise benefits from their mineral endowments and prevent the resource curse while others have not maximised the benefits? What should governments in these countries do to avoid the woes of the resource curse?

It is important to note here that the resource curse is not something unique to mineral-rich developing countries. Writing about why some countries are so rich and some are so poor, Landes (1999: 171–3) points out that from the age of discovery to the 18th century, Spain, probably at that time the wealthiest country in all of Christendom, used its money from its newly discovered territories on luxury and war and did not invest for the future. In other words, it became poor because it spent all its money ('unearned income') on non-productive ventures, the result of bad decisions.

In this sense, the question should not be whether mineral extraction is good or bad for economic development or even whether it is a result of an enclave development detached from the rest of the economy. The real question should be: do such countries have development policies and institutional frameworks that are capable of maximising the benefits for human development from mining and petroleum? And are such policies consistent, predictable and enduring? How and where should they invest the revenues for long-term broad-based economic development? How can such policies ensure that the benefits are used to build sustainable and durable productive capacity for real economic growth and poverty alleviation? Do leaders have the discipline to ensure that economic management and governance are entrenched in order to deliver sustainable development? Do they have the institutional integrity to support policy frameworks for sustainable development?

All of these questions are related. I think these are the real policy questions in relation to resource development, be that in mineral extraction, agriculture or manufacturing. How do they impact on the questions of public policy?

In a major study by Oxford Policy Management (Roe et al. 2004: 41) which studied 33 mineral-dependent countries — countries in which mineral production constitutes more than 40 per cent of total exports and contributes 10 per cent or more of the GDP — it was concluded that the difference between 'better' and 'poorer' performing countries was essentially to do with the quality of governance and the quality of macro-economic management. Clearly the determining factors were the 'capacity and efficiency of governance and institutions and how these are impacted by the presence of large scale mining'. This study pointed out that the so-called resource curse can be avoided and that 'there is no inevitability about it'.

I would argue that from the perspective of PNG, over many years, it has clearly been a combination of macro-economic management, sociopolitical institutions and governance structures that have contributed to poor performance. As an economic activity, mineral extraction has provided the country with huge opportunities to improve the performance of its economy and governance institutions, yet in many instances this opportunity has been squandered. The mineral sector should be considered a bonus (Auty 1993: 257) to facilitate opportunities for diversification of the economy.

Koyama (2005), writing about the externalities of oil production in the Southern Highlands of PNG, has shown that the poor development outcomes in that province are due largely to poor public policy choices, lack of governance, rent-seeking behaviour, corruption and, might I add, 'the culture of the big-man'. The opportunities provided by oil revenues could not be maximised under such conditions. Koyama did not argue that there should not be any investment in petroleum development but rather prescribed a number of 'antidotes' to cure what he described as the 'PNG disease' (2005: 22). The main thrust of his argument accords quite neatly with the commonality that exists between the traditional view and the new view. Neither view disputes the fact that mineral deposits can create human, physical and technological capital and bring about economic growth. Mineral resources provide a country such as PNG with opportunities for economic growth and human development but they have to be accompanied and protected by institutional integrity and governance provisions, which are accepted and supported by both the community and the leadership.

In a paper I delivered in December 2004 at the Eighth Papua New Guinea Mining and Petroleum Investment Conference, I argued that 'macro-economic stability is not sustainable without effective structural reforms and institutional integrity' and further noted 'that stability has to be grounded on institutions that improve the performance and productivity of the economy'. These include the institutions of decision-making, institutions of planning and central coordination, institutions of public policy and institutions of law and order. I noted that if there was going to be any success, such 'institutions have to be open, consistent and predictable, transparent and accountable'. Institutional integrity and durability is a prerequisite to disciplining a fiscal regime and improving the performance of public expenditure.

Addressing governance issues and implementing institutional reforms that would capture the benefits of mineral development can help to avoid the resource curse. PNG has attempted some corrective measures in this area. In the past it tried to establish governance structures to deal with mineral revenues through the Mineral Revenue Stabilisation Fund.

The Mineral Revenue Stabilisation Fund (MRSF)

The MRSF was designed as a fiscal tool to support prudent macro-economic management in an economy dominated by a few large resource projects, whose profitability was linked to cyclical world commodity prices (Auty 1993: 211). The legislation came into force in 1974. The rationale was to provide procedures for smoothing the flow of mine tax revenues to government. The MRSF set a basis for budget integrity and governance.

The statutory provisions of the act established rigid fiscal discipline. But even before the forced closure of Bougainville Copper in 1989, there were moves to amend and relax the provisions of the act. When the MRSF Act was revised in 1987, the Government was given greater discretion in making withdrawals from the fund. From the late 1970s and early 1980s, PNG adopted an expansionary monetary policy in anticipation of future revenues from its vast mineral resources and, as Parsons and Vincent (1991) showed, withdrawals from the MRSF increased significantly from 1980 to 1990. Little attention was paid to providing 'processes and policy settings so that the revenue collected from mining is spent' to build infrastructure and other productive capacity projects to ensure macro-economic sustainability (Parsons and Vincent 1991: 33). Needless to say, expenditure was highest in conspicuous consumption and in supporting the public service infrastructure in the period from 1980 to 1990. It is indeed a sad indictment of Papua New Guinea's governance that the act was diluted (amended) to allow ministerial and management discretion in the use of the MRSF, which supports the view that 'unearned' income of rentier states avoids reciprocal obligations between government and civil society (taxpayers) (DiJohn 2002: 3).

Institutional reforms

In the past 10 years, PNG has undertaken vigorous institutional reforms in the public and financial sectors, which could assist in capturing the benefits of mining and petroleum revenues. When Sir Mekere Morauta was Prime Minister, one of the amendments to the *Public Finances Management Act* was to restrict the use of budget surpluses to the repayment of public debt. This amendment ensures that 90 per cent of any budget surplus is used to repay public debt. It would seem that the current Treasurer, Bart Philemon, is utilising this provision.

During the past several years, macro-economic stability has been sustained, inflation has come under control, the currency has stabilised, foreign exchange controls are gradually being liberalised and public debt is declining. The economy is quite buoyant, but remains fragile as it continues to be a commodity-based economy susceptible to volatility caused by external and internal factors.

In the past decade, in the mineral and petroleum sectors, several reforms have taken place in order to address issues relating to community benefits.

Development forum

After the first-generation agreements of Bougainville Copper Limited and Ok Tedi Mining Limited, an initiative that changed the landscape of stakeholder relationships in mineral development and which was later extended to petroleum projects was the creation of what is known as the Development Forum. In 1988, the PNG Cabinet endorsed the creation of the Development Forum as part of the 'approval process' for large mining development. The requirement to convene a Development Forum has subsequently been included within the *Mining Act 1992* and the *Oil and Gas Act*. This is an established process in which the landowners in a mining or petroleum area, provincial governments and the National Government discuss their respective responsibilities and obligations in relation to a project to be developed and the associated benefits accruing to each group before the approval for development is given to the developer.

These discussions lead to the creation of a set of interlocutory Memoranda of Agreements (MOAs) outlining respective responsibilities and obligations. In many respects they articulate how the benefits are to be distributed between the various interest groups. Before 1992 these MOAs were part of public policy. With the review and amendment of the *Mining Act* in 1992, MOAs are now entrenched in law and have become a requisite for all major mineral and petroleum projects. In the early MOAs the developer was not a signatory, but was normally consulted and asked to brief the parties on the content of the 'Proposal for Development'. There were often misunderstandings by many leaders at that time that the developer was a signatory to these agreements, however, at that time the only agreement for which the developer was a signatory was the Mining Development Contract. In mineral developments since 1995, the developers have become signatories to the MOAs and have become an integral part of the benefits management process.

In its role as a mechanism to involve landowners and provincial governments in the process of resource development, the Development Forum has allowed discussions and decision-making processes to be more transparent as well as clearly qualifying and identifying benefits and accountabilities.

Tax Credit Scheme (TCS)

Invariably, mining operations take place in isolated and rugged regions where there are few or no existing government services. The geography of the mineral projects poses significant problems of inaccessibility for the Government and communities. Clearly, such conditions make it difficult for communities to be served adequately by government agencies, particularly when such agencies have weak administrative and technical capacities, even in the major population centres.

It has always been a concern to developers that mining revenues to the Government might not directly benefit the local communities in mining areas. In addition, isolated regions tend not to attract the kind of skills and expertise required to plan and implement infrastructure projects under difficult conditions. The recognition by mining companies that pre-existing conditions of poor development in isolated communities need to be urgently addressed led to discussions about industry involvement in assisting with key infrastructure development. In addition, such an approach would assist in providing social stability in a mining area, and a social licence for future development for a mining company.

In the early 1990s Placer Niugini Limited (now Placer Dome Niugini Limited) proposed a framework of tax rebates for infrastructure development that would be undertaken by developers on behalf of the Government.[3] It was agreed in 1992 that up to 0.75 per cent of the gross taxable income from a mining project would be used for approved infrastructure projects such as schools, roads and bridges and this expenditure would be deducted from tax to be paid by the project. To my knowledge, it does not happen in any other mining jurisdiction in the world, where 'a portion of the nation's share of benefits from mining projects has been handed back to the companies to fund local development' (Jackson 2005: 7). The process involves the landowners, provincial government and the developer agreeing to the types of project to be built and submitting the proposals to a committee of national departments (National Planning and Rural Development, Department of Mining or Department of Petroleum and the Internal Revenue Commission) for approval. In 2004, Porgera mine spent more than K70 million on TCS projects and Ok Tedi mine K19.25 million.

Mineral Resources Authority (MRA)

A recent reform that has great potential for good governance is the creation of the MRA. The Mineral Resources Bill has been approved by the National Executive Council and will soon be passed by the Parliament. Essentially this bill will convert the Department of Mining into a statutory authority, making it financially autonomous, giving it flexibility to recruit expertise and making it easier for it to engage short-term consultants in order to improve its performance. The aim is to make the MRA more effective in serving the industry through promotion and better regulation with the long-term objective of continued sustainable mineral-related revenue for the national budget. The board of the MRA is made up of government officials and private sector representatives in almost equal numbers. Obviously it will mean that the authority is going to be run more like a business entity than a government department.

Conclusion

To conclude, I would like to emphasise again that the differences in development outcomes between the 'poorer' and the 'better' performing mineral-rich countries lie in their quality of governance and the quality of their macro-economic management and how these are related to a mineral- and petroleum-extraction activity. It is not mining nor is it petroleum activity as such that is responsible for poor economic performance. Mining companies cannot do the work of a sovereign government. They can only assist and facilitate.

PNG has been criticised for not doing as well as it should. That's now a bit of history. I hope that I have shown how PNG is trying to improve its governance performance in utilising the opportunities created by mining and petroleum revenues. Major efforts have been made in public and financial sector reforms, which are likely to have a positive impact in managing the benefits from mining.

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ENDNOTES

[1] It could be argued that this was due to bad policy, which discouraged the development of competitive manufacturing and agricultural sectors. In the 1970s and 1980s many resource-rich countries, including mineral-dependent developing countries, pursued policies of import substitution supported by various forms of government subsidies, particularly at the period of surging nationalism.

[2] A mineral economy is one in which mineral production makes up more than 40 per cent of total exports and more than 10 per cent of GDP, according to World Bank definition.

[3] In about 1990, on my regular visits to Porgera gold mine in my capacity as the first General Manager of the Mineral Resources Development Company Limited (a member of the Porgera Joint Venture), I was once asked by Vic Botts, the then Managing Director of Placer Niugini Limited, if I thought there were ways the Bougainville crisis might have been avoided. Among other things, I told him that one of the things the North Solomons Provincial Government demanded in the negotiations during the review of the Bougainville Copper Agreement was to allow Bougainville Copper Limited to build selected and prescribed infrastructure in the province and have those costs deducted from its corporate tax. In this way the mining company would have been seen as contributing directly to the development of provincial infrastructure and, hence, be more acceptable to the community. I told him that senior Bougainville Copper Limited officials in private conversations were quite comfortable with the concept, but the National Government refused to listen to this suggestion at that time. I believe this discussion was the genesis of the Tax Credit Scheme, an initiative of Placer Dome, which became effective in 1992 and is now well accepted by all stakeholders.