Dawn of a new economy: for better or worse?

This year PNG enters its new era of LNG. Before Christmas the Prime Minister welcomed a double Christmas present with two LNG projects signed up, and there's a third possible down the track. This is pretty rapid progress, considering it was only 2007 that the Queensland gas pipeline was still the main prospect. Will PNG LNG (and possible further projects) provide the country the bonanza which some are predicting or some catastrophe, as others forecast? It is certainly a double-edged sword, with the potential to provide substantial benefits, but also impose considerable distortion, economic and social costs, as highlighted in last week's conflict between two normally harmonious Motuan villages. Whether the net benefits (to the country) outweigh the costs, or vice-versa depends very much how government and the wider community prepare, utilise and adapt to it, and how the developers behave and the wider private sector responds to challenges and opportunities.

PNG been surveyed geologically since the 1880s, with more rigorous oil exploration by Anglo-Persian (subsequently BP) since the early 1920s, and Oil Search from the late 20s. That effort finally paid off with commercial oil production commencing in 1992 from Kutubu and adjoining fields. Apart from early mining operations, notably around Bulolo, PNG's economy was almost exclusively agricultural until 1969, and mineral exports only surged ahead of agriculture and small forestry and fisheries industries from 1985. Oil production has been immensely valuable to PNG's economy since 1992, but the Kutubu fields are relatively modest by global standards, with gold, oil and copper jockeying as the main export earners over the past decade, with gold always ahead, except during a couple of years of high copper prices. Although the number of mining projects has increased in recent years, a few projects have dominated Government revenue, notably Ok Tedi, Porgera and Kutubu, whilst certain recent projects enjoy lucrative extended tax holidays. PNG is a gas rich, rather than oil rich country, and with the development of LNG as a major global industry the prospects for LNG here will dwarf oil.

A recent book "Crude World – The Violent Twilight of Oil" by Peter Maas of the New York Times, explores the massive and widely negative economic, social and environmental impact of oil production around the world, particularly developing and post-Soviet countries, with relatively weak governance systems, and agricultural or unsophisticated economies.

PNG was fortunate with oil. The 1990s are often described as a wasted decade, and oil, combined with other mineral projects contributed to high expectations and 'Resource Curse' effects, especially combined with the impact of Bougainville's costs and revenue loss and extravagant governments. Developers Chevron and partners, notably Oil Search, gave an exemplary performance, in terms of minimising environmental impact, working with local communities and providing direct community services. Nevertheless, PNG's two richest provinces (Southern Highlands and Western) provided vivid examples of the resource curse, with breakdown of already weak governance, with Western seeing little from the vast payouts, and incessant false invoices paid by authorities in Daru, and Southern Highlands frittering it resources on ivory towers and duplicate positions, whilst hitherto sound services collapsed, and heavily armed feuds between local warlords grew. It's true that good cooperation between various national agencies led to the arrest of many officials in

Mendi, but services and governance in the Southern Highlands (and formative Jiga province) remain rudimentary. The Health Minister promises a new hospital from LNG for Tari, but why hasn't the existing and formally reputable hospital been sustained using SHP's more than adequate funding?

Developing major natural resource invariably triggers dramatic economic and social changes, however careful the preparation. The simple message, however, is that those countries which plan well (investing revenue in genuine economic and social priorities, like core infrastructure, education and training, and sanitise a portion of future revenue –notably in a 'future' or 'sovereign' fund, and effectively coordinate fiscal and monetary management), have or establish effective and transparent institutions and vigorously address corruption, and tackle impediments to business and investment (including encouraging competition), will benefit from major resource development, even if some industries suffer and the economy changes composition. Developed countries, such as oil-rich Norway, and developing countries, such as diamond-rich Botswana, fall in this positive category, with Botswana having one of the lowest corruption rates in Africa.

By contrast many oil(/gas) rich developing countries (Peter Maas might say most), have experienced deteriorating, or at least stagnant services, much of their economy collapsing (agriculture to manufacturing), corruption universal and a small elite consuming a disproportionate share of benefits, often accumulated in overseas property and bank accounts, armed conflict rife, notably between beneficiaries and those feeling aggrieved, often bearing the brunt of the harmful environmental impact. Nigeria and Equatorial Guinea are examples experiencing the plunder, rot and conflict associated with oil development.

Experience has shown that awaiting wealth to arrive and fix up deficient institutions, infrastructure and services provides false promise, with the revenue turning into a mirage as negative Dutch Disease impacts set in, from burgeoning expectations, greed and disputes (as highlighted in Boera/Porebada), sky-rocketing real estate and other prices, and potential wider inflation and appreciating exchange rates, and booming abuse of public funds.

The good news is that LNG is a long term resource with less direct environmental impact/risks than oil. Over the past 10 years there have been a series of important reforms, notably early last decade, critical to sound economic management. The Central Bank (BPNG) was made independent and has achieved solid performance in stable monetary management, especially when combined with (until lately) largely prudent fiscal management, helping restrain inflation. The superannuation funds were saved from atrocious abuse by management and government, with greater independence, prudential requirements and Central Bank supervision. So, after the 1990's odious track record for fund management, including with the Mineral Resources Stabilisation Fund, PNG can (once again) claim positive performance with some fund management. The NEFC's expenditure monitoring and assessments of actual service delivery costs provide invaluable planning tools for Budget allocations, to help achieve targets for social indicators, including MDGs. Some aspects of the economy have been freed up, including competition in mobile phones and increasingly in other ICT.

The bad news is that despite an excellent Constitution, laws and a full range of institutions, to deliver and oversee executive government, most public institutions are poorly performing or not performing at all, thanks to years of politicisation of appointments and undermining meritocracy and standards, and often starved of funds for core functions (leaving donors to shore up supplies or medicines or school materials, for example). Departments like Lands and Agriculture should be converted to authorities, accountable to the public/producers or, as with DAL, closed down. Currently DAL has apparently forgotten PNG's own farmers and perceive their role as servicing demands of sometime questionable business interests, making vast land (or forest) grabs around the country, without landowners' apparent informed consent. After attempts to close Trust Funds in the early 2000s, they've burgeoned, with public service systems further sidelined by MPs (sometimes from frustration or good intentions), who are effectively controlling vast sums, with inadequate planning or accountability, and projects benefiting a select few or funds expended but reportedly never implemented. Few if any are penalised for abuses, whilst fiscal prudence seems to be slipping again, with Medium Term financial strategies abused (as with 2009 Trust Funds).

The failure to make real headway in: -

- public sector reform (including right-sizing and greater independence from political interference, e.g. for the Police),
- tackling corruption or electoral abuses,
- maintaining fiscal focus and prudence,
- restoring the oversight and operational functions of Parliament and generally improving public accountability, or
- advancing reforms related to freeing up the private sector (including rolling back State monopolies, in services or utilities),

bode ill for the country's future and the majority benefiting from LNG development.

LNG development comes in two phases, both with their own impacts (positive and negative). The first, really apparent from the third quarter of 2010, will see a workforce of around 10-12,000 constructing the pipeline and processing facilities near NCD and SHP. Most employees will comes from overseas, but large numbers of locals will be trained, but invariably many will be sucked from other more cash-strapped industries. Many fear that other industries, including agricultural and manufacturing will be main sufferers, and push costs to the brink. This is already happening.

During the second phase the workforce will subside to a modest, but steady 500, in this capital intensive industry. Other industries may recoup staff or access newly trained staff, if their business remains operational. However, failure to restrain undue currency appreciation will threaten prospects for other export or import replacement based businesses. Many of these, notably agricultural, provide the country's broad-based employment, directly as smallholders or on estates, but also in many associated industries. Future revenue from LNG could provide needed long term investment in priority (restoring and upgrading) infrastructure and services, including training and education, needed for the public and businesses to access markets, public goods and wider opportunities.

The options are in the country's hands, but sitting on our hands and expecting goodies to arrive, failing to plan realistically and address the country's many constraints, immediate needs and reforms, will ensure PNG, and especially the majority, fail to see tangible benefits, whilst the potential for fuelling disharmony and conflict is very real. With LNG revenue not until 2017 or beyond, mining(and declining oil) will continue to provide the bulk of revenue, whilst agriculture must be protected and fostered for the majority's benefit. Donor support will also remain critical. Squandering public funds, as in 2009 on unaccounted projects and executive jets, when, despite the LNG promise, the majority still have no services, cannot continue.