

PIPE DREAMS

The PNG LNG Project and the
Future Hopes of a Nation



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ABOUT JUBILEE AUSTRALIA

Jubilee Australia is an independently funded non-government organisation committed to addressing the root causes of global poverty.

We undertake research to expose the policies of the Australian government and practices of Australian business that perpetuate long term impoverishment in the Asia Pacific, and we call for changes to the global economic rules of engagement that foster fairness and sustainability. We are driven by our solidarity with civil society groups, networks and people's movements in the Global South who are fighting for justice and their right to a better future.

Jubilee Australia emerged out of the international Jubilee 2000 movement, which saw 24 million people from around the world sign a petition calling for 'Third World' debt cancellation.

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(Centre) Women in Yehimbole Village, Yangoru-Saussia District, East Sepik Province.
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(Right) Abandoned mine equipment, Bougainville,
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ABBREVIATIONS

| | | | |
|--------|--------------------------------------------------------------------|--------|--------------------------------------------------|
| ADB | Asian Development Bank. | IPBC | Independent Public Business Corporation. |
| APT | Additional Profits Tax. | K | Kina. |
| ASX | Australian Stock Exchange. | LANCO | Landowner-controlled businesses. |
| AusAID | Australian Government Overseas Aid Program. | LBBSA | License-based Benefit Sharing Agreement. |
| BDG | Business Development Grants. | LNP | Liquefied Natural Gas. |
| BRA | Bougainville Republican Army. | MDGs | Millennium Development Goals. |
| BSA | Benefit Sharing Agreement. | MMtpa | Million Metric tonnes per annum. |
| CEO | Chief Executive Officer. | MRDC | Minerals Resources Development Company (of PNG). |
| CNGL | Chevron Niugini Limited. | MRSF | Mineral Resources Stabilisation Fund. |
| CPI | Consumer Price Index. | NEC | National Executive Committee. |
| CSR | Corporate Social Responsibility. | NGO | Non-Government Organisation. |
| DFAT | Department of Foreign Affairs and Trade. | NPCP | National Petroleum Company of PNG. |
| DNPM | Department of National Planning and Monitoring (Papua New Guinea). | NRF | National Resources Fund. |
| DPE | Department of Petroleum & Energy. | ODA | Overseas Development Assistance. |
| ECA | Export Credit Agency. | PDL | Project Development License. |
| EIC | Expenditure Implementation Committee. | PIA | Project Impact Area. |
| ECIA | Economic Corridor Implementation Agency. | PNG | Papua New Guinea. |
| EFIC | Export Finance and Insurance Corporation. | PNGSDP | PNG Sustainable Development Program. |
| EHL | Esso Highlands Ltd. | SEC | US Securities and Exchange Commission. |
| EIS | Economic Impact Study. | SIA | Social Impact Analysis. |
| EITI | Extractive Industries Transparency Initiative. | SOE | State-Owned Enterprise. |
| EU | European Union. | SWF | Sovereign Wealth Funds. |
| GDP | Gross Domestic Product. | UBSA | Umbrella Benefit Sharing Agreement. |
| GNI | Gross National Income. | UN | United Nations. |
| HGDC | Hides Gas Development Corporation. | | |
| IDG | Infrastructure Development Grants. | | |
| ILG | Incorporated Landowner Group. | | |
| IMF | International Monetary Fund. | | |
| IPBC | The Independent Public Business Corporation of Papua New Guinea. | | |

The Companies:
Oil Search Limited, Santos Ltd, JX Nippon Oil and Gas Exploration Corporation, Papua New Guinea Petroleum Company and Nippon Oil Exploration (Niugini) Ltd.

EXECUTIVE SUMMARY

This investigative report by Jubilee Australia highlights circumstances, events and impacts associated with Exxon Mobil's \$US19 billion Gas Project in Papua New Guinea's (PNG) Southern Highlands.

The PNG LNG Project is the largest single development in the history of Papua New Guinea, and the Pacific. The Project will see ExxonMobil and its joint venture partners, Oil Search, Santos, JX Nippon Oil and Energy, and the PNG Government, arrange for the extraction of the large gas resources deep underground in the country's Southern Highlands, and their shipment by pipeline from the newly-created Hela Province, to Caution Bay near Port Moresby, where they will be liquefied and sold to energy-hungry buyers in East Asia. The Project is expected to generate as much as \$US30 billion in tax, levy and royalty receipts to the PNG Government over the 30 years that the gas will flow.

This Report is the most complete discussion to date of the potential risks and benefits of the Project to the people of PNG; it argues that, contrary to the official discourse, there are serious risks that the revenues generated by the project will not mitigate the negative economic and social impacts of the Project. In fact, it is very likely that the Project will exacerbate poverty, increase corruption and lead to more violence in the country.

Pipe Dreams also discusses the nature and the implications of the Australian Government's financial and institutional support of the PNG LNG Project, continuing Jubilee Australia's investigation of Australia's export credit arrangements first revealed in the 2009 report, *Risky Business*. In December 2009 the ALP Government directed the Australian export credit agency, the Export Finance and Insurance Corporation (EFIC), to offer up to \$US400 million in credit from the publicly funded National Interest Account, to ExxonMobil and the other Project partners.

BACKGROUND

PNG's formal economy is heavily dependent on resources, with a high degree of foreign ownership. Existing alongside this is a very large informal economy on which the majority of Papua New Guineans still depend for their livelihood. Since the 1980s, the increasing dominance of the formal economy by foreign-owned mining projects has challenged the traditional strength of the agricultural sector and created economic volatility, exacerbated by poor governance and management of the lucrative mining wealth.

Connections to land still play a central role in daily life and kinship networks (the wantok system) remain the strongest source of identity for PNG people.

Public life is beset with political intrigue, flagrant self-interest, and largely dysfunctional governance. The mining sector has often been at the centre of PNG's political contestations, with the clearest example being

the destructive conflict on the island of Bougainville in the late 1980s and 1990s.

There exists an abundance of evidence in support of the theory that developing countries with natural resource wealth tend to have slower growing economies, stubbornly corrupt systems of government, and inter-societal conflict. In recent years a broad consensus has held that greater revenue transparency is the best way to inoculate against this 'resource curse'.

Other work probing the more intractable problems of resource dependence suggests that, in the case of oil-rich states such as Nigeria, an 'oil complex' can develop, where not only is the entire economy and political system reconfigured by the fusion of the state with the multinational oil companies, but the desire of local groups for access to resource revenues gradually reconfigures most forms of political and ethnic identity as well.

In the same way that Nigeria has developed an 'oil complex', PNG may very well be following suit with the emergence of its own 'gas complex.'

This reports' primary research objectives and the associated findings are summarised below:

1. SCRUTINISING THE OFFICIAL PREDICTIONS

The Project's supporters and the PNG National Government have argued that PNG LNG will be good for the country and integral to its future growth and development. The first research objective of this report is to place under scrutiny the official predictions made about the Project, with a view to answering the question - are the overwhelmingly positive predictions that have been made about PNG LNG realistic, or are they simply pipe dreams?

KEY FINDINGS

Project Negotiations

Bolstering claims first made in 2009 in its *Risky Business* Report, Pipe Dreams has uncovered more evidence that the process leading up to the signing of the PNG LNG deal was compromised by a desire on behalf of both the PNG Government and the Companies to prioritise the sign off over all else. As with many similar project finance arrangements in other parts of the world, the structure of the deal places an unreasonably large share of the risk, should things go wrong with the Project, on the Government and thus the people of PNG.

When it comes to the critical issues of landowner identification and negotiation, on which the success or failure of the Project may ultimately rest, responsibility for oversights and failures in due diligence technically rests more with the PNG Government than the

Companies. Nevertheless, the Companies were aware from a very early stage that the Government would in all likelihood not be meeting its obligations on this matter.

Economic Impacts

The direct economic benefits offered by the PNG LNG are modest at best. Capital investment and employment are location and Project specific: less than 7 per cent of the \$US10 billion spend is estimated to be sourced locally; and the construction boom employment opportunities will be temporary and provide little net benefit for human capital development.

The government revenues received over the life of the Project will be very large, yet will not necessarily 'spread throughout the economy' as predicted, nor provide long term improvements in the quality of life for the people of PNG. Significant questions must be asked about the likelihood of these revenues being spent well, given the National and Provincial Governments' poor track record as principle vehicles for delivering benefits to citizenry.

Furthermore, the positive predictions within the PNG LNG's official Economic Impact Statement about the indirect benefits of the Project for the broader PNG economy stand up poorly under scrutiny: the model employed to predict the multiplier effects is based on unrealistic assumptions and is unfit for making forecasts; the touted large boost to GDP has been dismissed by other sources as irrelevant to the net welfare benefit to PNG; and the projected outlook for PNG's trade balance, exchange rate, sectoral impacts and labour market is challenged by other sources.

The sharp increase in the size of the petroleum export sector will have dangerous distortional effects on the rest of the economy. The most recent economic indicators from PNG show that Dutch Disease is spreading, with the country's forestry, agriculture and fisheries industries worst affected by the inflationary effects and appreciating currency that have resulted since commencement of the PNG LNG Project. These non-mining and petroleum export sectors are contending with a sharp surge in manufacturing costs and increased competition from foreign imports.

The prospect of increasing poverty and worsened living conditions for rural Papua New Guineans is very real and hinges on the successful design and implementation by government institutions of expenditure policies to counter the LNG-induced negative impacts on the agriculture and forestry sectors in particular. At the same time, the inflationary pressure already present in the economy means that even the smallest increase in government spending could exacerbate aggregate demand and overheat the economy.

Institutional Challenges

The various institutions through which the different PNG LNG revenue streams are collected, protected, managed and spent will be crucial to the success or otherwise of the Project for the people of PNG. Serious doubts exist about the efficacy of the institutions nominated as recipients for the bulk of the National Government revenues.

The Australian Government has argued that the establishment of a well-designed Sovereign Wealth Fund will enable 'effective and transparent governance' of the PNG LNG revenues and ensure that the earnings from its natural investment in gas reserves will be preserved over the longer term. But a more balanced assessment suggests that while a transparent and accountably managed Sovereign Wealth Fund model will assist, it will not, in and of itself, guarantee a positive outcome for the people of PNG.

Evidence from cases around the world demonstrates that most misappropriation of natural resource revenue occurs long before the money reaches a Sovereign Wealth Fund. Therefore, to be effective transparency must apply down the entire PNG LNG revenue chain, from when money is paid by the Companies to the Government, to the points at which the revenues are distributed and spent by national and sub-national authorities. In this regard, PNG's implementation of the Extractive Industries Transparency Initiative (EITI) would be the most effective method to facilitate verification of revenue information at a national level, although the initiative would not enable local communities to know how much wealth has been received or should be disbursed by sub-national bodies.

Political reform in PNG is the most important insurance against official abuse of the PNG LNG revenues. Given the complex nature of politics in PNG, reform is a long-term project involving the gradual integration of modern-state democratic traditions. This is more likely to take place, if at all, across many decades rather than in the space of a few short years.

Local Revenue Distribution and Risk of Project-related Conflict

Ahead of the anticipated 2014 production start date, reports from affected communities suggest the PNG LNG Project has generated a mix of outcomes so far. While many have experienced financial benefits, others have been affected by a range of adverse social consequences. Regular instances of violence, disputes and unrest have occurred over employment opportunities and political interference in the distribution of certain benefits.

The manner, efficiency and fairness with which the production phase benefits are spent and distributed will probably be the key factor in determining whether the Project is seen to be a success or a failure by those living in the Project areas. The institutions which exist to distribute the revenues and the business opportunities embody a complex melange of social forces. Most are marred by serious problems of governance with problematic track records.

Although the risks of serious violence are impossible to predict accurately at this time, if important segments of the community feel excluded from the Project's benefits, the potential for conflict will most certainly rise. Landowners have already indicated that they will not respond well to unmet expectations and disappointments. This remains possibly the greatest threat to the lasting success or failure of the Project, especially as these warning signs have been paid little heed by PNG LNG proponents.

2. ASSESSING INTERNATIONAL AND AUSTRALIAN INVOLVEMENT

The process by which international actors make decisions to financially and diplomatically support projects of this sort is rarely subjected to scrutiny. The second research objective of this Report is to shed light on motivations of the various international actors involved in making the PNG LNG Project happen. An independent assessment of these processes is especially necessary with respect to the Australian Government, which has long played such an important role in the politics of Papua New Guinea, and whose support was central to getting the Project off the ground.

KEY FINDINGS

PNG LNG is the largest project financing deal ever made, with a significant proportion of the debt finance required for the Project provided by five major national export credit agencies (ECAs). The involvement of these ECAs can best be explained by the fact that private corporations from their home country are either involved in the Project joint venture itself, are buyers of the gas, or have been assured of being awarded a share of the lucrative Project construction contracts.

The decision of the Australian Government to give its largest ever export credit loan to support the PNG LNG Project was made in a closed door Cabinet meeting, without Parliamentary discussion, and on the basis of documents submitted to Cabinet that have not been made available to the public.

Statements by Australian Government officials in Parliament and by the Australian Export Finance and Insurance Corporation (EFIC) justify Australia's majority tax-payer funded investment in the Project on the basis of (1) the significant equity stake that two Australian-listed corporations have in the Project – 43 per cent – and (2) the billions in lucrative procurement profits that Australian contractors are expected to gain from the Project. It is probable that any concerns brought to the Government regarding the risks inherent in the Project were overridden by commercial concerns.

The significance of Australia's involvement in supporting the PNG LNG Project reaches far beyond its relative small share of the total debt package arranged by the joint venture. Australia's involvement through EFIC was key to the Project securing the financial backing of other ECAs as well as the commercial banks. In the words of Oil Search's Managing Director, Peter Botten:

As the local expert, other ECAs stated that the presence, experience and professionalism of EFIC in evaluating and supporting the financing was critical in their participation to the level achieved. EFIC was seen as the local specialist on PNG and other ECAs looked to them for support and commitment, representing the full backing of the Australian Government.¹

The Australian Government will thus share the largest burden of complicity in any serious Project-related trouble which unfolds in PNG. The Trade Minister's and the Cabinet's decision to both financially and diplomatically support the Project was at best questionable, and quite possibly irresponsible, given the abundance of evidence pointing to the on-going crisis of governance and governability in PNG, and the risk this would pose to the success of the Project and to the welfare of the most vulnerable people in PNG.

As a result, this research presents perhaps the strongest evidence to date that decisions by the Australian Trade Minister to place facilities on the publicly funded National Interest Account of EFIC require greater scrutiny. It further bolsters the conclusions of the final report of the Productivity Commission Inquiry into Australia's Export Credit Arrangements, released June 2012.

CONCLUSION

The final conclusion of the Report is as follows: the context, the timing and the negotiation processes surrounding PNG LNG have resulted in the greatest risks of this Project being borne by the people of PNG. The greatest benefits will be accrued by the foreign actors who are developing these gas reserves for their own ends. This should raise a genuine concern for all those who care about the future of PNG.



Road safety on the road from Tari to Nogoli.
Photo credit: James McIraith/University of Otago.

¹ Oil Search Ltd's post-draft submission, Productivity Commission Inquiry into Australia's export credit arrangements, 20 March 2012. Available at: <http://pc.gov.au/projects/inquiry/export-credit/submissions#post-draft>

INTRODUCTION

The commercialisation of the vast gas resources of our country would be the number one priority of this government -- Former Prime Minister of Papua New Guinea Michael Somare (2008).¹

Let's put aside the moral, humanitarian, do-good side of what we believe in, and let's just talk, you know, straight realpolitik. We are in a competition with China. Take Papua New Guinea, huge energy find [...] ExxonMobil is producing it. China is in there every day in every way trying to figure out how it's going to come in behind us, come in under us.

US Secretary of State Hilary Clinton (2011).²

The PNG LNG Project will see ExxonMobil and its partners, including the PNG Government, arrange for the extraction of the large gas resources deep underground in the country's Southern Highlands, and their shipment by pipeline from the newly-created Hela Province, across the mountains, under the sea and onto Caution Bay, near Port Moresby. There the gas will be liquefied in a special-purpose plant, loaded onto cargo ships and taken to energy-hungry buyers in East Asia.

The Project, with projected capital costs of \$US19 billion (K39 billion), is the largest single development in the history of the country. It is expected to generate between \$US1 to 1.5 billion (K2 to K3 billion) in tax, levy and royalty receipts for the PNG Government annually during the 30 years of gas flow.³ If successful, the Project may spur future gas projects in the country. Whether or not this happens, it is almost certain to convert the PNG economy to a gas economy.

As the statement by former Prime Minister Sir Michael Somare demonstrates, great promises have attended the Project since its inception. It has not merely been argued that the PNG LNG will be good for the country, but that the country's future growth and development depends on its successful implementation. In fact, in the official discourse of both the PNG Government and international governments supporting the Project, the narrative about the potential benefits of the Project to the country has been the dominant one. This is despite the uncertain evidence that huge resource projects of this nature can be harnessed for growth and prosperity in countries like PNG, and despite PNG's decidedly mixed record thus far of successfully capitalising on its resource wealth.

The primary aim of this Report is to examine critically the official projections made about the impact of the Project on the PNG state, economy and society. It is critically important to put to the test official predictions about PNG LNG, especially as no such over-arching analysis has thus far been attempted. By trying to come up with answers to the above

questions, the aim is to provide an alternative lens through which the citizens of PNG may view the largest development project in the history of their nation.

To this end, the questions this Report seeks to answer include: What kinds of transformations - political, economic and social - are likely to attend the Project? Who will benefit from the Project and who will lose out? What sorts of institutions does PNG have in place to manage the revenues and to deliver them? Will the interests of PNG's poor be served? What will be the specific impacts on communities the Southern Highlands? To sum up: Are the overwhelmingly positive predictions that have been made about PNG LNG realistic, or are they simply Pipe Dreams?

A second aim of this research is to shed light on the motivations of the various international actors involved in making the Project happen. As the Congressional Testimony quoted above from Secretary Clinton's indicates, a full understanding of the PNG LNG story is impossible without first describing the various interests of international players in developing PNG's natural resources. Yet the process by which international actors make decisions - financially and diplomatically - to support projects of this sort is rarely subjected to scrutiny. An independent assessment of these processes is especially necessary with respect to the Australian Government, which has long played such an important role in the politics of Papua New Guinea, and whose support was central to getting the Project off the ground. In this sense, the Report is a continuation of Jubilee Australia's 2009 publication *Risky Business*, which raised serious questions about the transparency and accountability of Australia's export credit agency, EFIC. Two and a half years on, we continue this line of questioning by exploring the PNG LNG case in much greater depth.

The principal aim of this Report is not to deliver a set of recommendations or to suggest a course of action for the PNG Government or its citizens. The complexity of the issues involved and the great uncertainty as to how matters will develop in PNG in the coming years require commentators to maintain a degree of humility in this regard. Rather, it is our opinion that advocacy-related research of this kind should be focussed on challenging the actions of those whom it is within our remit and ability to influence: in this case, the Australian Government and its export credit agency. We also hope that this research will serve to inform other advocates, public officials and our fellow citizens about these important issues.

¹ "Papuan Possibilities," *Gas Today Australia*, August 2009, http://gastoday.com.au/news/papuan_possibilities/001423/

² "US flags fight for PNG resources," *The World Today* (ABC Radio), 7 March 2011.

³ For this report we are using the conversion rate of 2.06 kina to one US dollar, which is the exchange rate as of 18 March 2012. We have adjusted the investment figures from K54 to K31 billion due to the appreciation of the kina against the US dollar since 2008.

CHAPTER OVERVIEW

The Report consists of five chapters:

Chapter 1 provides an overview of the PNG economy and discusses the country's political and cultural institutions. It then discusses existing research on resource-dependence and provides some evaluation of its strengths and weaknesses and relevance to the case of PNG.

Chapter 2 examines the main actors involved in the Project. It first examines the various and intersecting interests of the international participants, including the companies, governments, financiers and buyers. It then looks at the role of the key Papua New Guinean actors in the Project before giving a brief history of the legal framework and consultative process surrounding the deal.

Chapter 3 looks at the economic impacts of the Project, with a strong emphasis on the predictions made by the consortium's official economic impact study. The economic impacts are examined from three perspectives: the direct economic benefits, the economy-wide benefits, and economic considerations regarding the overall fiscal framework of the country.

Chapter 4 examines the political and institutional context into which the PNG LNG revenues will flow. It first provides a sketch of the path through which revenues will move, before outlining the condition of the state-owned revenue-management institutions, the possibilities for revenue-transparency, and the role of and considerations surrounding PNG's new Sovereign Wealth Fund.

Chapter 5 discusses the impacts of the Project on the communities most directly affected by it, especially those of the Hela Province in the Southern Highlands. It looks first at the impacts the Project has already had on the region. It then considers the role and problems of the institutions that will manage and distribute the revenues at the local level as the Project gains steam. Finally it identifies the possible long-term economic and social impacts, including the risks of Project-related conflict.

Methodological concerns

Desk analysis of primary documents concerning PNG LNG and other official public documents relating to the political, economic and social situation in PNG constitute the core research involved in this Report. A critical part of the research took place during a visit to PNG in June 2011, during which time experts in the government, international organisations and civil society groups were consulted. This has been buttressed by interviews and discussions with other academic, industry and civil society colleagues in Australia and elsewhere over the last two years. Academic studies and other secondary literature have been drawn upon where appropriate.

1 OVERVIEW, CONTEXT AND THEORETICAL CONSIDERATIONS

This Chapter provides an overview of the historical and contemporary political and economic setting in PNG, as well as a brief discussion of the theoretical issues relevant to this Report. Section 1.1 outlines important characteristics of the PNG economy from past to present. Section 1.2 examines the interactions between PNG's traditional institutions and the more modern aspects of the state. Finally, by way of theoretical context, section 1.3 takes note of relevant academic and research work completed in recent years on the conundrum of natural resource dependence in developing countries. This Chapter aims to provide an introduction to the PNG context and the theoretical considerations relevant to this work, in order to buttress the remaining chapters of the Report. Readers who are familiar with PNG and the literature on natural resource dependence, or who are motivated primarily by a desire to understand the PNG LNG Project, may wish to move straight to Chapter 2.

1.1 THE PNG ECONOMY

Since its independence in 1975, PNG has charted an uneven and volatile economic course.¹ In addition to the traditional dominance of agriculture discussed in the next Section, three characteristics are important to note about PNG's economy:

- **Export-dependence:** PNG has suffered from limitations to infrastructure and transport networks, plus the isolation of its population centres. These domestic market capacity constraints have meant that economic growth is generally export-led.²
- **Foreign Ownership:** The country's largest export sectors, forestry and mining, have a high proportion of foreign ownership—a scenario common in many less-developed economies. Given the repatriation of profits and intermediate imported inputs, the net welfare effect to the PNG economy of some export sectors is only a third of the value of their foreign exports.³
- **The Informal Sector:** The ADB recently reported that less than ten per cent of the economically active population is engaged in formal private sector employment.⁴ The large nature of the informal

sector has implications for PNG. While those in the formal sector can offset inflation by wage growth, particularly the private sector workforce, those in the informal sector are much more vulnerable to cost of living increases. The high level of labour absorption into the informal economy keeps the official unemployment rate low (it was 2.8% in the year 2000).⁵ Some sources suggest as many as 1.5 million Papua New Guineans are unemployed, and seven out of ten new entrants to the workforce are excluded from the cash economy.⁶

Taken together, these three factors – export dependence, foreign ownership and a large informal sector – mean that GDP growth is not a particularly useful measure of the health of the PNG economy. This is, firstly, because GDP growth largely mirrors export earnings and is highly sensitive to commodity price fluctuations;⁷ secondly, GDP data is inflated by export-industry profit, though most of this profit will be expatriated overseas; and thirdly, because it fails to acknowledge the contribution of the informal sector.⁸

AGRICULTURE VS MINING

Agriculture - including forestry and fisheries - has played a central role in the PNG economy by providing between 30-40 per cent of GDP over the last three decades.⁹ In particular, exports from palm oil, coffee and cocoa comprise 85-90 per cent of agricultural export revenue since 2000.¹⁰ This reliance on agriculture is unsurprising considering that 80-87 per cent of the population live in rural areas with a heavy dependence upon the natural resources of forested areas for their livelihood and culture.¹¹ As much as 85 per cent of the population is supported by semi-subsistence agricultural activities.¹² The government's

adb.org/sites/default/files/pub/2012/pacmonitor-201203.pdf, 17.

5 National Statistical Office of Papua New Guinea, Labour Force Statistics, http://www.spc.int/prism/country/pg/stats/Pop_Soc_%20Stats/Social/Labour%20Force/labour.htm.

6 Australian Parliament, "Economic Challenges facing Papua New Guinea and the Island States of the Southwest Pacific," Senate Foreign Affairs, Defence and Trade References Committee, vol.1 (November 2009), 191.

7 Aaron Batten and Linda Duncan, "Measuring PNG's Development Performance Report (1975-2000)" in Papua New Guinea's Development Performance 1975-2008, eds. Thomas Webster and Linda Duncan, op. cit., 30.

8 For an outline of Papua New Guinea's informal economy see John Conroy, "A national policy for the informal economy in Papua New Guinea," Pacific Economic Bulletin 25, no.1 (2010), 189-204 and Independent State of Papua New Guinea, Informal Sector Development and Control Act 2004, http://www.paclii.org/pg/legis/consol_act/isdaca2004401/.

9 See PNG Government Department of Treasury, 2011 Budget: Revenue and Grants, vol.1, 166, http://www.treasury.gov.pg/html/national_budget/files/2011/budget_documents/Volume%201/2011.Budget_volume1.pdf; Aaron Batten, Jonathan Gouy and Ron Duncan, "Papua New Guinea Economic Survey: from boom to gloom?", Pacific Economic Bulletin 24, no.1 (2009), 1-4; Faal, op. cit., 16-18

10 Giles Dickenson-Jones, and Albert Wijeweera, "An Empirical Analysis of Price and Income Elasticities of Papua New Guinea's Exports," Pacific Economic Bulletin 25, no. 2 (2010), 140-142.

11 World Bank, "Note on Cancelled Operation (NCO)" (PE-4398/GE4345), Report No. 36503, 13 October 2006, 3; See also AusAid, About Papua New Guinea, October 2009, http://www.ausaid.gov.au/country/png/png_intro.cfm.

12 AusAid, op. cit.; See also Australian Parliament, op. cit., 190.

1 For a detailed historical overview see Aaron Batten, "Fiscal Policy" in Papua New Guinea's Development Performance 1975-2008, eds. Thomas Webster and Linda Duncan, National Research Institute (NRI) Monograph No.41, September 2010, http://www.nri.org.pg/publications/Recent%20Publications/Dvp_Report_with_cover_300810.pdf, 67-104 and Charles Hawksley, "Papua New Guinea At Thirty: late decolonisation and the political economy of nation building," Third World Quarterly, 27, no.1 (2006), 161-173.67-104 161-173

2 Ebrima Faal, "Growth, Investment and Productivity in Papua New Guinea," Pacific Economic Bulletin 22, no.1 (2007), 18. Also see PNG Government, Medium Term Development Strategy 2005 - 2010, Our Plan for Economic and Social Advancement, November 2004, <http://aciir.gov.au/files/node/777/PNG%20medium%20term%20development%20strategy%202005-2010.pdf>, 7.

3 Laurence Chandy, "Linking Growth and Poverty Reduction in Papua New Guinea" (Lowy Institute for International Policy, 2009), 10.

4 Asian Development Bank, "Pacific Economic Monitor," March 2012, <http://www>.

Medium Term Development Strategy 2005-10 states that 'agriculture will remain the mainstay of the economy for decades to come', offering the best prospect for broad-based economic growth.¹³



PNG marketplace. Photo credit: Antony Loewenstein.

Some analysts argue that a distinction should be made within the cash-cropping sector between industrial scale agriculture (like the palm oil sector which is similar to other large extractive industries in the Melanesian economy), and smallholder-controlled crops like coffee and cocoa. One PNG expert talks of the so-called 'four legs of Melanesian heavy industry':

oil and gas, mining, forestry and palm oil.¹⁵ The high levels of foreign ownership in each of these sectors have implications for the long-term development of the Pacific nation.

Mining has long been the next most important sector after agriculture (see Figure 1). Four major mining projects have dominated the economy in recent decades: Ok Tedi, Misima, Lihir, Porgera. In the 20 years from 1982 to 2001, these four projects have generated around K3.6 billion in income for the PNG government.¹⁶ In the era before this, the dominant feature of the PNG economy was the Bougainville Panguna mine (see Box 1.2). Although agriculture is the strongest sector as measured in GDP terms, it is the mining sector which has been responsible for earning a much larger proportion of foreign exchange. For example, from 1998 to 2008, whereas the total contribution of agriculture, fisheries and forestry was 20 to 30 per cent of the value of total exports, over 70 per cent came from mining, oil and gas.¹⁷

Figure 1 below presents a picture of the startling rise in significance of petroleum to PNG's economy. By 2015, the oil and gas sector is predicted to eclipse the agricultural sector as PNG's main contributor to nominal GDP (the gradient of the oil and gas curve being slightly less steep if real GDP were used). The figure also shows the significance of the Project-

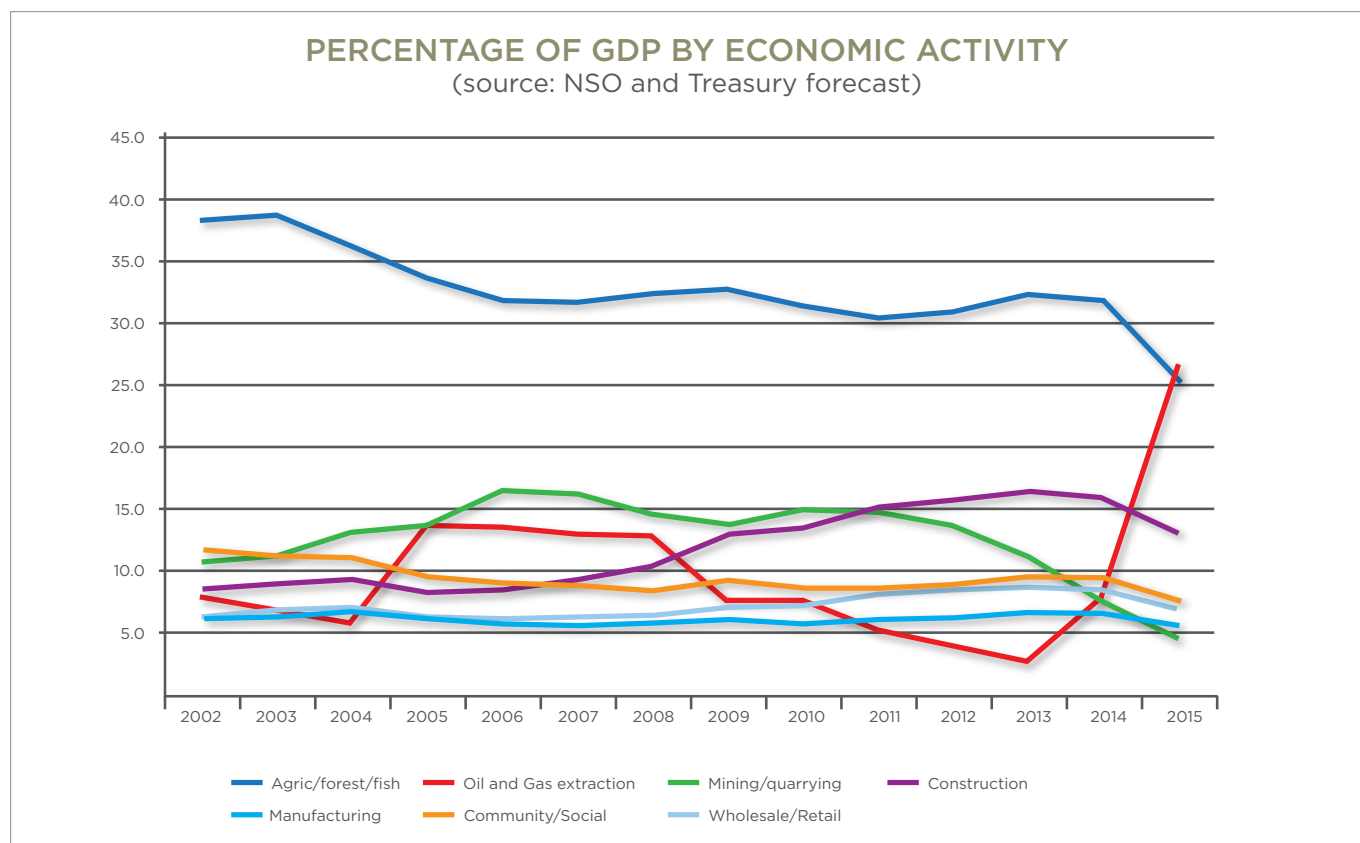


Figure 1: Percentage of GDP by Sector (Source: Institute of National Affairs, 2011).¹⁴

¹³ PNG Government, op. cit., Medium Term Development Strategy 2005 - 2010, v, 13.

¹⁴ Paul Barker, "Impact of the LNG Project on Agriculture and Managing Resource Wealth," LNG and Agriculture Workshop, Institute of National Affairs (INA), 31 March - 1 April 2011, http://www.inapng.com/pdf_files/LNG%20Development%20and%20Agriculture.pdf.

¹⁵ Colin Filer, "Local Custom and the Art of Land Group Boundary Maintenance in Pua New Guinea," in Customary Land Tenure and Registration in Australia and Papua New Guinea: Anthropological Perspectives, eds. James F. Weiner and Kate Glaskin, Asia Pacific Environment Monograph 3 (Australian National University E Press, 2007), 139-140.

¹⁶ See Department of Mining, Green Paper - Sustainability planning framework for the mining sector in Papua New Guinea, February 2003, http://www.consultpdm.com/publications/png_mines_green_paper.pdf, 2.

¹⁷ See ACIL Tasman, PNG LNG Economic Impact Study: An assessment of the direct and indirect impacts of the proposed PNG LNG Project on the economy of Papua New Guinea (2008, revised April 2009), http://pnglng.com/media/pdfs/publications/acil_tasman_impact_study_revision_01.pdf, 22.

related construction boom to the economy at the present time.

BOOM AND BUST: THE 1990S

The 1990s saw considerable volatility in the PNG economy, which was a result of an increased reliance on mining, oil and gas and the subsequent economic mismanagement of the associated revenues.¹⁸ Strong GDP growth between 1991 and 1993 on the back of the Ok Tedi and Misima mines,¹⁹ saw the PNG government rapidly increase its expenditures. However, by the mid 1990s overspending and mismanagement resulted in fiscal crisis.²⁰ The instability of mega-mining projects, most notably Bougainville's Panguna mine, contributed to this problem.²¹ Together, a decline in mineral revenues, combined with inflation, exchange rate appreciation and associated profligate spending on imports, gave rise to balance of payments pressure and, eventually, an enormous debt overhang. By 2002, public debt levels were 72% of GDP and the country's main sovereign wealth fund was drained in order to cover the losses.²²

The IMF was eventually called upon to supervise an adjustment program, but the damage had already been done.²³ By 1996, 41 per cent of PNG's rural population and 16 per cent of the urban population were living below the poverty line.²⁴ Furthermore, the period of 1996 to 2002 saw per capita GDP contract sharply (by 4.8 per cent)²⁵ and real GDP grow by less than one per cent, with average income dropping from \$US1300 (1994) to \$US744 (2000).²⁶ The period became known as PNG's 'lost decade' of development.

Since 2002, higher primary commodity prices for key cash crops, timber, minerals and petroleum have helped the PNG economy stabilise.²⁷ This decade has been marked by consecutive real GDP growth of 4.5 per cent per annum.²⁸ Given the concurrent steady growth in population, the per capita GDP growth is slightly more moderate.²⁹ Government revenue already steadily grew from 2003 to 2009, with non-mineral revenue gradually contributing a greater proportion over time.³⁰

POVERTY

As mentioned above, poverty in PNG increased significantly during the period between 1996 and 2004.³¹ World Bank estimates using the \$US1.25 per day standard calculate the rise in poverty levels from 38 to 54 per cent in this period.³² Recent estimates suggest that from 2004, poverty levels have fallen by around 9 per cent (according to the \$1/day estimate), which places poverty at around 27 per cent today.³³ Overseas Development Assistance (ODA) accounted for 17 per cent of PNG Government revenue in 2010,³⁴ or 5 per cent of GDP.³⁵ Australia remains by far PNG's largest aid donor: in 2010 bilateral aid from Australia represented 68 per cent of total ODA grants received by the PNG Government; the amount of Australian foreign aid is predicted to rise to K1 billion in 2012 (compared to the second largest contribution of 76 million Kina from the United Nations).³⁶ PNG is not on track to achieve any Millennium Development Goals (MDG) targets before 2015.³⁷

Geographic disparity in the prevalence of poverty has continued since 1996, at which time the World Bank estimated 41 per cent of the rural population fell below the poverty line, compared with 16 per cent of the urban population.³⁸ Up to 70 per cent of PNG's rural poor are primarily dependent on the agricultural sector for their livelihoods, either for subsistence or for cash crops.³⁹ The rural poor suffer more heavily from malnourishment and greater isolation from infrastructure and services. Two-thirds of all childbirths in PNG occur unsupervised, and only one quarter of the national road network is in good condition.⁴⁰

Although a decrease in poverty has accompanied the economic stabilisation since 2004, evidence suggests that this decrease has almost entirely been due to the growth in the non-mining sector.⁴¹ This is not surprising given it is estimated that a one per cent increase in income in the non-mining sector cuts poverty nine times more than a one per cent increase in income in the mining (including the petroleum) sector.⁴²

18 Ibid.

19 Bank of Papua New Guinea, *Money and Banking in Papua New Guinea* (2007), quoted in Batten, op. cit., 74.

20 Batten, Gouy and Duncan, op. cit., 1-7; Faal, op. cit., 20-21.

21 Batten, op. cit., 72.

22 For details, see Martin Gould, "Managing manna from below: sovereign wealth funds and extractive industries in the Pacific," *Economic Round-up 1* (2010), 77. See also Paul Barker, *Impact of the LNG Project and Managing the Wealth from the Project*, notably through a Sovereign Fund, Presentation to the Sovereign Wealth Fund Workshop, May 2010, 8.

23 Hawksley, op. cit., 169-170.

24 See also Jenny Hayward-Jones and Stephanie Copus-Campbell, "Tackling Extreme Poverty in Papua New Guinea - Outcomes Report," (Lowy Institute for International Policy, 2009), 1-10.

25 Faal, op. cit., 22.

26 David Kavanamur, "Papua New Guinea," *The Contemporary Pacific*, Fall 2002, 456.

27 Batten, Gouy and Duncan, op. cit., 1-2 and Table 1.

28 See the Hon. Don Polye, Papua New Guinea's continued economic growth, Papua New Guinea Advantage Conference, Brisbane Convention Centre, 5 August 2011. See Figure 3.33.1 in Asian Development Bank, *Asian Development Outlook 2011: South-South Economic Links*, 2011, 226.

29 AusAid, 'About Papua New Guinea,' October 2009, http://www.ausaid.gov.au/country/png/png_intro.cfm; Asian Development Bank, *Asian Development Outlook 2009: Rebalancing Asia's growth*, April 2009, 297.

30 PNG Government Department of Treasury, op. cit., 2011 Budget, 44.

31 There is a level of contestation around the concept of poverty in PNG. For a detailed discussion of poverty in PNG see Diana Cammack, *Chronic Poverty in Papua New Guinea - Background Paper for the Chronic Poverty Report 2008-09* (Chronic Poverty Research Centre, 2007), 21-24. See also World Bank, *Papua New Guinea: Poverty Assessment* (2004), <http://siteresources.worldbank.org/INTPAPUANEWGUINEA/Resources/PA-Report.pdf>, 4.

32 Ibid., 4; Faal, op. cit., 20-21.

33 Chandy, op. cit., 1-2. For a detailed discussion of poverty in PNG see Cammack, op. cit., 21-24.

34 PNG Government Department of Treasury, op. cit., 2011 Budget, 38. "ODA accounts for approximately 60 per cent of Tuvalu's GNI; 44 per cent of Nauru's; 13 per cent of Vanuatu's; and 11 per cent of Samoa's GNI. Tonga (8.8 per cent) and Fiji (2 per cent)," see Australian Parliament, op. cit., 14.

35 For international and regional comparisons see Eric Kwa, Stephen Howes and Soe Lin, *Review of the PNG-Australia Development Cooperation Treaty (1999)*, April 2010, 18.

36 See PNG Government Department of Treasury, 2012 Budget: Overview and Revenue, Vol.1, http://www.treasury.gov.pg/html/national_budget/files/2012_budget_documents/Volume1/chapters/vol1.chapter3.pdf, 42.

37 See the AusAid assessment of PNG, 2009 at http://www.ausaid.gov.au/country/png/png_intro.cfm.

38 World Bank, *Papua New Guinea: Poverty and Access to Public Services*, October 28 1999.

39 Datt and Walker, "Does mining sector growth matter for poverty reduction in Papua New Guinea?" *Pacific Economic Bulletin* 21, no. 1 (2006), 71.

40 Chandy, op. cit., 5

41 Ibid, 4-5.

42 Datt and Walker, op. cit., 77.

1.2 PNG'S SOCIAL AND POLITICAL INSTITUTIONS

Since gaining independence from Australia in 1975, Papua New Guinea has taken some actions to address the legacies of the highly centralised colonial state, including efforts to disperse political power to individual regions outside Port Moresby. Shortly after independence, the PNG Parliament passed a law to devolve powers to newly-created Provincial Governments. But the power devolution has been an incomplete one, and since that time until the present, there has been something of a power struggle between the National Government and the Provincial Governments.⁴³ Today, PNG's political culture consists of an uneasy marriage of 'traditional' social relationships and mores on the one hand, with elements of a 'modern' or bureaucratic state structure on the other. The next two Sections look to both the 'traditional' and 'legal-bureaucratic' facets of PNG politics and society, and consider some consequences of their interaction.

CUSTOMARY LAND AND RELATIONSHIPS

Customary land (land communally held by indigenous groups according to custom) forms the cultural, spiritual, political and economic backbone of PNG life for the vast majority of Papua New Guineans; its ownership is strongly linked to tribe and clan identity.⁴⁴ In the words of one researcher:

In Papua New Guinea landownership is vested in descent groups—tribal or clan segments. All clan members are co-owners. This gives individuals the right to use land but not to alienate it. Thus, land ownership is part of the identity of a group. It is an inalienable right, passed from the ancestors into the guardianship of successive generations.⁴⁵

Although traditionally a very high percentage of land in PNG has been customary land, it has been argued



Children in Kokopo, PNG. Photo credit: Stephanie Lusby.

43 Ben Scott, "Re-imagining Papua New Guinea," *Lowy Institute for International Policy*, (2005), 81-100 ; Alphonse Gelu, "Politics and Governance" in *Papua New Guinea's Development Performance 1975-2008*, eds. Thomas Webster and Linda Duncan, op. cit., 141-165.

44 Dan Jorgensen, "Clan-Finding, Clan-Making and the Politics of Identity in a Papua New Guinea Mining Project," in *Customary Land Tenure and Registration*, eds. Weiner and Glaskin, op. cit., 60.

45 Susan Toft (ed), *Compensation Resource Development in Papua New Guinea*, Law Reform Commission of Papua New Guinea, Australian National University, National Centre for Development Studies and Resource-Management in Asia-Pacific Project (1997), 60.

that this proportion has been declining in recent years with the institution of new leaseback schemes.⁴⁶ Unsurprisingly, attempts to reform customary land tenure and registration have been highly sensitive and triggered considerable community angst and conflict. In 2001 the World Bank's attempt to initiate customary land registration programs resulted in protests, riots and police killings in Port Moresby.⁴⁷

Connected to land ownership and descent groups are traditional patronage systems, or wantok networks. Wantok means 'one language' and generally refers to people of the same language group.⁴⁸ These remain the closest bonds that PNG individuals feel, and are stronger than national identities.⁴⁹ Wantok ties create a strong sense of obligation and reciprocity among groups members, and play an extremely important role as a social safety net. Chapter 5 will discuss the way in which wantok networks have been distorted and abused through their incorporation into the negotiation process over revenue flows from extractive industry projects, while benefit-sharing has become destructively intertwined with the long tradition of mutual obligation and political and clan competition.⁵⁰

THE CONTEST BETWEEN LANDOWNERS AND THE STATE OVER NATURAL RESOURCES

The conflict between national, regional and tribal identities has often found expression in the struggle for resource riches. The laws of PNG vest ownership of what lies below the sub-surface to the state, including all mineral and petroleum deposits.⁵¹ But in a country with so many large and controversial mining projects (Panguna, Lihir, Ok Tedi, Porgera, and Misima) conflict is common between the state and the locals in whose land resources sit.

The reaction that many landowners have had towards state attempts to assert its rights to mineral wealth was summed up by one Lihir Landowner many years ago: 'The developers and foreigners and the State are only a concept. It is us, landowners, who represent real life and people.'⁵² This struggle is exemplified by the case of the civil conflict in Bougainville (see Box 1.2). While the violence and loss of life in Bougainville

46 The most commonly cited figure is 97 percent (Department of National Planning and Monitoring, *Papua New Guinea Medium Term Development Plan 2011-2015*, October 2010, 25). However Colin Filer has recently argued that between 2003 and 2011, as much as 11 percent of PNG's land has "passed into the hands of foreign corporate entities" ("The Political Construction of a Land Grab in Papua New Guinea"), Paper Presented in international conference on "Global Land Grabbing" at the Institute of Development Studies, (UK) 6-8 April 2011).

47 Jim Fingleton, "A Legal Regime for Issuing Group Titles to Customary Land: Lessons from the East Sepik" in *Customary Land Tenure and Registration*, eds. Weiner and Glaskin, op. cit., 15.

48 Scott, op. cit., 51-53 .

49 David Lea, "New Initiatives in the Development of Customary Land Group Versus Individual Interests," *Pacific Economic Bulletin* 24, no.1 (2009), 62.

50 Some analysts argue that this attitude stems from the history of PNG society, "where any additional power or wealth obtained by ancestral enemies could be a future disadvantage." See Joseph Ketan, *The name must not go down: political competition and state-society relations in Mount Hagen, Papua New Guinea* (Suva: Institute of Pacific Studies, University of the South Pacific 2004), 158-216, cited in Scott, op. cit., 47.

51 Independent State of Papua New Guinea, *Oil and Gas Act 1998*, http://www.paclii.org/pg/legis/consol_act/baga199894/, Section 6.

52 Landowner Mark Soipang, originally quoted by Colin Filer, "Participation, governance and social impact: the planning of the Lihir gold mine," in Chris Ballard and Glenn Banks, "Resource Wars: The Anthropology of Mining," *Annual Review of Anthropology* 32 (2003), 296-7.

is the most obvious and horrific example of what a breakdown in the relationship between the government and landowners can lead to, many of PNG's other major mines have been dogged with controversy—from environmental destruction (Lihir and Ok Tedi)⁵³ to human rights abuses carried out by security forces associated with mining projects (Porgera).⁵⁴

Following Bougainville, there developed an increased push for political decentralisation in PNG and for strengthening the rights of landowners over resource riches on their property. The subsequent changes to the country's mineral policy in the last two decades have increased landowner access to these revenues. Parliamentary reform, introduced in 1996, opened up the potential for greater revenue allocations from mineral resources to local and provincial governments.⁵⁵ In new resource projects, the National Government is required to make an agreement with the landowners (and provincial and local governments) on how a portion of the revenues will be distributed before any final agreement is reached. See Section 2.3 on how this has played out in the case of PNG LNG.

BOX 1.2: BOUGAINVILLE'S PANGUNA MINE AND CIVIL WAR

For many years the Panguna mine was the largest feature in the PNG economy. At one time the world's largest open-pit copper mine, at its peak it was producing \$US1 billion per year in copper, gold and silver exports. According to one estimate, Panguna provided 16 per cent of government income and a staggering 44 per cent of exports.⁵⁶ But the dark side of this windfall emerged when the mine became associated with the conflict and bloodshed of Bougainville's decade-long civil war. From 1989 to 1997, a local resistance movement, the Bougainville Republican Army (BRA), fought national defence forces sent to quell the rebellion. During the civil war, it is estimated that ten per cent of the island's 200,000 people died and 40 per cent were displaced. Control of the revenues from the island's Panguna mine was central to the conflict, as many Bougainvillians felt that they were not getting their fair share of their natural wealth. At the same time, national politicians were accused of pillaging Bougainville's minerals to fill the national coffers, and for their own private benefit. Identity issues and the independence of the Bougainvillians played an important part in the dispute. The final year of the conflict was

53 On the legal dispute surrounding the Ok Tedi mine's environmental impact and associated legal dispute, see Glenn Banks and Chris Ballard (eds), *The Ok Tedi Settlement: Issues, Outcomes and Implications* (Canberra: Australian National University, 1997).

54 Human Rights Watch, *Gold's Costly Dividend: Human Rights Impacts of Papua New Guinea's Porgera Gold Mine*, Human Rights Watch, February 2011, <http://www.hrw.org/sites/default/files/reports/png0211webwcover.pdf>.

55 National Economic and Fiscal Commission, *Review of Inter-governmental Financial Arrangements: Background Paper on Provincial Financial Management and Accountability Systems*, 2002, <http://www.nefc.gov.pg/Archives/Higgins%20RIGFA%20FM&Accountability%20V2%2030-10-02.pdf>, 1-3.

56 Jo Connell and Richard Howitt, "Mining, Dispossession, and Development" in *Mining and Indigenous Peoples in Australasia*, eds. John Connell and Richard Howitt, (Sydney: Sydney University Press, 1991), 1-18.

dominated by the infamous Sandline Affair, in which the National Government planned to send mercenaries to fight the rebels, an incident that contributed to the collapse of the PNG Government in 1997.⁵⁷

CORRUPTION, WEAK GOVERNANCE AND POLITICAL INSTABILITY

Corruption

Mention of corruption is ubiquitous in discussions on PNG. One expert defines corruption as 'the misuse of public office for personal gain': public office is abused and misused when an official accepts or solicits a bribe, or when a private agent offers bribes in order to circumvent public policies and processes of competition for advantage and profit.⁵⁸ Similarly, corruption can be defined as instances wherein 'professional managers and their associates [...] use their positions of power and authority for their own collective and individual political and economic interests.'⁵⁹ Corruption is often found when Western political institutions are transplanted onto a more 'traditional' social system - especially ones like PNG that have been distorted by colonialism and resource extraction. The complex tension between Western and traditional values plays out most obviously at the local level, where modern bureaucratic governance comes up against the Melanesian wantok system. Politicians, it has been argued, are expected to provide money and appointments to their family and wantok network, a process which undermines the efficacy of public service and of the political process.⁶⁰

Although one can argue that what is considered to be corruption (i.e. abuse of power or immoral/unethical behaviour in the political realm) can depend on one's cultural frame, many Papua New Guinean authors do not shy away from using the concept. John Collins Hevie has listed the most common forms of what he would consider as 'corruption' in his native country: 1) not following the correct procedures in a tendering or procurement process; 2) double dipping (receiving two incomes at the same time); 3) nepotism (favouring one's relative or village patrons for financial or employment opportunities); 4) politicisation of public appointments; 5) interference by politicians in administration; 6) receiving of commission or kickback; 7) misuse of power—especially in relation to the appointment of public officials; 8) misuse of funds; 9) lack of moral judgement; and, 10) condoning unacceptable behaviour.⁶¹

57 See Yash Ghai and Anthony J. Regan, "Unitary state, devolution, autonomy, secession: State building and Nation building in Bougainville, Papua New Guinea," Round Table 95, no. 386 (2006), 589-90 and Joanne Wallis, "Ten Years of Peace: Assessing Bougainville's Progress and Prospects," Round Table 101, no.1 (February 2012), 29.

58 John Collins Hevie, "Forms of Corruption" in *Corruption in Papua New Guinea: Towards an Understanding of Issues*, eds. Albert Ayius and R.J. May, National Research Institute (NRI) Special Publication No.47, November 2007, 17-22.

59 Albert A. Ayius, "An Overview of Corruption" in *Corruption in Papua New Guinea: Towards an Understanding of Issues*, eds. Albert Ayius and R.J. May, op. cit., 1-4.

60 Sophie Temby, *Good Governance in Papua New Guinea: an Australian Agenda*, University of Melbourne: School of Social and Environmental Enquiry (2007), 28; Oskar Kurer, "The Papua New Guinean Malaise: from re-distributive politics to failing state." *Pacific Economic Bulletin* 21, no. 1 (2006), 84-93.

61 Collins Hevie, op. cit., 19-20.

Commissions and inquiries into wastage and corruption by PNG's Department of National Planning and Monitoring (DNPM) demonstrate that key departments have been unable to prevent large scale misappropriation of public funds.⁶² For example, a judicial inquiry into corruption within the Department of Finance publicly released in 2010 found evidence of millions of dollars worth of graft.⁶³ In the words of *The Australian's* PNG specialist, Rowan Callick, the report uncovered 'a dramatic and pervasive web of corruption'. Some of the more incendiary findings of the inquiry included a brazen \$AU700,000 graft by the Finance Secretary Gabriel Yer, who shared the money with kinsmen from his local village, and evidence of \$AU1.5 million worth of fraudulent compensation claims by Isaac Lupari, former head of the Public Service and economic adviser to Sir Michael Somare.⁶⁴ The cases identified in 2010 only add to an already-long list of allegations and findings about high-level graft and corruption by PNG's government officials.⁶⁵



(Above and Right) Images of National Elections in PNG, June 2012. Photo credit: Stephanie Lusby.

Findings from the most recent investigation into the DNPM, entitled Task Force Sweep, were reported to Prime Minister Michael O'Neill in May 2012 and have only served to reinforce this picture of continuing and institutionalised government corruption. Established in August 2011, the investigation had made 35 arrests as of May 2012, including current and former parliamentarians and public servants, and had recovered more than \$AU20 million, with more than double that amount identified for recovery over the following six months.⁶⁶

Task force chairman Sam Koim described the level of government corruption as 'frightening'.

62 See Public Accounts Committee, Parliamentary Report on the Inquiry into the Department of National Planning and office of Rural Development, <http://www.parlcmnts.gov.pg/docs/Planning.pdf>

63 Cathy Davini, Maurice Sheehan and Don Manoa, Commission of Inquiry Generally into the Department of Finance - Final Report, 29 October 2009, <http://pngexposed.files.wordpress.com/2010/08/final-report.pdf>.

64 Rowan Callick, "\$300 Million Pillaged in Papua New Guinea Graft," *The Australian*, 30 April 2010, <http://masalai.wordpress.com/2010/04/30/300-million-pillaged-in-papua-new-guinea-graft/>.

65 In 1994 the Public Officers' Superannuation Fund (POSF) purchased a building in Cairns to house PNG Government Officers working in Northern Australia. According to the PNG Ombudsman's investigations, associates of Sir Julius Chan, including his own political party, stood to make a considerable financial gain from this and an associated deal. Andrew Fowler, "The Insider: A banker's tale of big money, political manipulation and failure," *Four Corners* (ABC), 24 July 2002, <http://www.abc.net.au/4corners/stories/s590512.htm>; Transparency International, National Integrity Systems - Country Study Report: Papua New Guinea 2003 (Institute of National Affairs, 2003), 16-17.

66 Joe Gurina and Gorethy Kenneth, "Task Force Sweep Team a success," *Post-Courier*, 11 May 2012, <http://www.postcourier.com.pg/20120511/news03.htm>.

His investigations reportedly found that a corrupt 'mobocracy' had begun to control PNG's resources to the extent that it was undermining the country's development. Casualties from the investigation included former Planning Minister Paul Tiensten, who will stand trial for allegedly approving a \$AU1.5 million grant to fix a copra plantation and depositing the money with one of his own companies, amongst other charges.⁶⁷

Another facet of the misuse of public funds includes the widespread and longstanding use of public money to fund private electoral campaigns. For decades, Government revenues have been diverted from public programs to fund candidates for National Parliament.⁶⁸ A 1987 Commission of Inquiry into the forestry sector, for example, found that election fraud was endemic. Former Minister of Forests, Ted Diro, infamously stated at the time that it was 'common in PNG for politicians to use the returns from business to secure votes.'⁶⁹ As one analyst noted at the time:

The whole parliamentary system is now lubricated by cash. Candidates unable to count on party organisations or the loyalty of supporters to win elections rely on monetary or other material incentives to win votes. Reciprocity and ethnic ties have become the basis of politics.⁷⁰



67 Liam Fox, "Corrupt 'mobocracy' undermining PNG democracy," *ABC News*, 11 May 2012, <http://www.abc.net.au/news/2012-05-11/png-corruption-widespread/4004694/?site=brisbane>.

68 T. Regan, O. Jessep and E.Kwa (eds.), *Twenty Years of the Papua New Guinea Constitution*, (Law Book Co, North Ryde 2001), cited in Alphonse Gelu, op. cit., 141-161; See also Peter Ekeh, "Colonialism and the two publics in Africa: A theoretical statement," *Comparative Studies in Society and History*, No 17 (1975), 91-112, cited in R.J. May, *State and society in Papua New Guinea: the first twenty-five years* (Melbourne: UIN, 2001), 319-320.

69 Gelu, op. cit., 148.

70 Yash Ghai, "Establishing a liberal political order through a constitution: The Papua New Guinea experience," *Development and Change* 28, no.2 (April 1997), 325.

Governance

Similarly a Western concept, and also commonly employed in discussions of PNG, is the notion of 'weak governance'. Broader than corruption, 'governance' refers to the legal system within which political authority is exercised. The strength of a country's governance (that is, the extent to which it can be described as 'strong' or 'weak') is commonly judged by the efficacy of the legal framework to restrain political actors. PNG performs poorly across almost all governance indicators including: rule of law; government effectiveness; regulatory quality; and, political stability compared with its regional neighbours.⁷¹ Weak governance (including ineffective democratic institutions) may not in itself amount to corruption, yet it tends to enhance the potential for it. For example, the weakness of the PNG political system was arguably what allowed a legislative change to the public service appointment process, something that has likely made corruption in the country much worse.⁷²

PNG's chronic political instability has undermined its capacity to produce reliable political institutions. Some of the most significant and ongoing problems analysts have pointed to include: the absence of a meaningful party system and the domination of the political scene by powerful personalities; more changes of government on the floor of Parliament than at elections; and a tendency of parliamentarians to represent clan rather than national interests. These problems were described by one observer as representing 'an ongoing crisis of governance and governability'.⁷³ Political instability also includes attacks on whistleblowers who seek to dislodge a culture of impunity for graft and corruption. The 2009 attempts on the life of the PNG Ombudsman fall into this category.⁷⁴

The relative calm of the last few years does not mean these problems have disappeared. In 2011-12, a power struggle between Sir Michael Somare and new Prime Minister Peter O'Neil brought the country to the brink of political chaos. The problems came rather sensationally to a head in January 2012, when Somare attempted to overthrow his successor O'Neill in a military coup.⁷⁵ The attempt failed, but the event once again highlighted recurrent political instability in the country.⁷⁶

A 2007 AusAID report claimed that corruption in PNG was 'taking a decided turn for the worse, with potentially serious implications for political governance

and stability'.⁷⁷ US diplomatic cables recently published by Wikileaks show that in 2007, Australian diplomatic staff were told by their US counterparts that generational change in PNG was a 'lost hope'.⁷⁸

The Wikileaks release of the so-called 'Stratfor Files' raises serious doubts as to whether Peter O'Neill can stem these problems.⁷⁹ A source in the files, later revealed to be former Australian Senator Bill O'Chee, described O'Neill as:

[...] quite corrupt. I know him. He is manipulated by a rather bad egg from Norway, who couldn't run a used car lot, but is now O'Neil's economic advisor [...] As long as he [O'Neill] makes money for himself (he has significant business investments in mobile phones, among other things), he couldn't really care less.⁸⁰

O'Chee did concede that if Sir Mekere Morauta was appointed Treasurer it would be a positive development.⁸¹ In the same leaked Stratfor files, O'Chee also made the following general observation:

The other issue is that the standard of the political class is clearly lower than it was 15 years ago. The old guys got corrupt and lazy, and outdated. The newer guys have been obsessed with personal wealth, and lack the respect for the offices they hold, which the previous generation had. This, at least, was the view presented to me privately on Wednesday evening, by one of the most senior diplomats.⁸²

The UN has also painted a concerning portrait of governance in PNG today:

Worsening health and social indicators, deteriorating physical infrastructure, poor planning and coordination mechanisms, [and] a debilitated public service combined with unequal access to the benefits of natural resources are increasingly hampering efforts towards nation building.⁸³

In short, significant evidence exists to raise questions about whether there is an end in sight to the corruption, weak governance, and political instability that has plagued PNG for decades.

71 For aggregate World Bank Governance Indicators for a number of Pacific nations see Australian Parliament, op. cit., Economic challenges facing Papua New Guinea, 222. It is important to note PNG's poor ranking in the regional context.

72 Gelu, op.cit., 146.

73 Ben Reilly, "The Africanisation of the South Pacific," Australian Journal of International Affairs 54, no.3 (2000), 261-268.

74 Jubilee Australia, *Risky Business: Shining a Spotlight on Australia's Export Credit Agency*, December 2009, 34.

75 "Military Revolt Shreds Somare's Credibility," SMH Online, 27 January 2012, <http://www.smh.com.au/opinion/editorial/military-revolt-shreds-somares-credibility-20120126-1qjnc.html>. For critical analysis see "Somare admits responsibility for military mutiny," PNG Exposed, 28 January 2012, <http://pngexposed.wordpress.com/2012/01/>.

76 In the Stratfor emails, see more below, former Australian Senator Bill O'Chee claimed that O'Neill was able to replace Somare through the support of business contacts from Enga Province. Philip Dorling, "Wikileaks, Stratfor, And Papua New Guinea's Corrupt Politics," Asia Sentinel, 6 March 2012, http://www.asiasentinel.com/index.php?option=com_content&task=view&id=4299&Itemid=601.

77 AusAID Office of Development Effectiveness, *Approaches to anti-corruption through the Australian aid program: lessons from PNG, Indonesia, and Solomon Islands* (2007), 19.

78 Philip Dorling, "Australia, US damn PNG's rotten political practices," The Age, 3 September, 2011, <http://www.theage.com.au/world/australia-us-damn-pngs-rotten-political-practices-20110902-1jq9a.html>.

79 For analysis see Philip Dorling, op. cit. O'Chee, whose links to Papua New Guinea's elite are said to go back to his Oxford University days, was given an "A" rating by Stratfor for source reliability.

80 Wikileaks, Global Intelligence Files 5095199, http://wikileaks.org/gifiles/docs/5095199_-_alpha-more-re-more-re-insight-png-new-pm-via-cn65-.html.

81 Wikileaks, Global Intelligence Files 100230, http://wikileaks.org/gifiles/docs/100230_-_alpha-insight-png-update-cn65-.html.

82 Wikileaks, Global Intelligence Files 5060472, http://wikileaks.org/gifiles/docs/5060472_-_alpha-insight-png-feedback-on-analysis-cn65-.html.

83 United Nations, "Key Development Challenges," http://www.un.org/pg/index.php?option=com_content&view=article&id=6&Itemid=11.

1.3 RESOURCE-ABUNDANT DEVELOPING COUNTRIES IN THE GLOBAL ECONOMY

Many countries have endeavoured to develop their economies and build prosperity on the back of large resource projects. Time and time again, however, countries taking this path have come up short. What can we learn by tracing the history of other natural resource-rich developing countries?

THEORY OF THE RESOURCE CURSE

The theory of the 'resource curse' seeks to explain the connection between natural resource riches and poor or stalled development. The theory has gained much traction over recent decades from a variety of actors, including scholars (especially economists and political scientists), global development institutions and civil society groups, and journalists. In fact, the resource curse has been described as 'one of the few issues on which the IMF, development guru Jeffrey Sachs, the humans rights industry, the Catholic Church, and millions of urban poor are in full agreement'.⁸⁴ The vast literature on the curse of natural resource wealth can be classified into: 1) explanations that emphasise economic factors; 2) explanations that focus on the distortion of institutions; and, 3) those that highlight an increased incidence of violent conflict.

Where did the theory originate? Since at least the 1950s, development economists have debated whether natural resource-based development is possible and/or desirable. One of the most prominent early explanations of poor economic performance after a resources boom was a phenomenon dubbed 'Dutch Disease' after the experience of Holland in the late 1950s. In economic terms, Dutch Disease describes a situation whereby the inflow of revenues causes currency appreciation and inflation. This reduces the competitiveness of exports in other sectors like agriculture and manufacturing and increases the price-competitiveness of imports. As price-competitiveness of imports increases, economic retraction in non-extractive sectors occurs and extractive sector growth is undermined.⁸⁵

The connection between natural resource wealth and poor economic performance was not seriously examined by economists until the 1980s.⁸⁶ While many cited Dutch Disease, others argued that poor economic performance after resources booms occurs due to the 'enclave' nature of resource sectors, i.e. because resource sectors typically employ few local workers and do not tend to produce what economists

call 'linkage effects' in the broader economy.⁸⁷ The propensity for natural resource commodity prices to fluctuate more widely or to decline in their terms of trade versus the prices of other commodities has also been offered to explain the problems of resource dependence.

In his influential 1990 article on the resource curse, Michael Ross argued that all such conditions have only the potential to undermine economic development. For example, the idea that resource-dependent economies develop 'enclave' characteristics may be said to depend on political or business elites choosing not to invest or develop skills in other sectors like manufacturing. The critical question for Ross was this: do governments apply the right policy tools to mitigate and overcome the resource curse, and if not, why not?⁸⁸

As resource curse literature grew over the years, the study of narrow economic explanations for the problem started to give way to a desire to find more institutional reasons for the failure of resource rich countries to thrive. Drawing on ideas from political science literature about Middle Eastern 'rentier' and African 'patrimonial' states, theorists focussed on the idea of resource-rich states as 'predatory'.⁸⁹ Because of the ease of access to mineral resource 'rents', the state does not have to develop institutions that could encourage economic development, entrepreneurship, revenue distribution, effective public spending or the rule of law. Instead, political elites in resource rich countries simply use the resource wealth to pay off political opposition, to reward their political supporters, and to enrich themselves, all the while supported by weak state institutions that turn a blind eye to - or are actively complicit in - corruption that is part of this system.⁹⁰ Representative of this approach is Terry Lynne Karl's 1997 work on 'petro-states', *The Paradox of Plenty*.⁹¹

A subset of this political and institutional work of resource curse literature is work that links resource wealth with the undermining of democracy and human rights. There are two mechanisms at play here: 1) state dependence on resource rents undermines the necessity to tax the general population, thus removing the sense of government responsibility to its citizens; and 2) resource wealth is often spent on increasing the capacity of the state's security apparatus, which in turn, is used to quell dissent against government policies.⁹²

87 For the classic presentation of these challenges see Richard M. Auty, *Resource-Based Industrialisation, Sowing the Oil in Eight Developing Countries* (New York: Clarendon Press, 1990).

88 Michael Ross, "The Political Economy of the Resource Curse," *World Politics* 51, no.2 (1999), 301-307.

89 Peter Evans, "Predatory, Developmental, and Other Apparatuses: A Comparative Political Economy Perspective on the "Third World State," *Sociological Forum* 4, no. 4 (1989), 561-87.

90 Ross argues that there are actually three types of arguments that connect resource-dependence with political weakness/failure: cognitive, societal and state-centred. See Ross, op. cit., 308-319.

91 The work focussed heavily on the political economy of Venezuela, but also contained several other case studies: Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley: University of California Press, 1997). For a more recent example see Robert Deacon, "The Political Economy of the Natural Resources Curse: A Survey of Theory and Evidence," *Foundations and Trends in Microeconomics* 7, no. 2 (2011), 111-208.

92 Mathias Basedau, *Context Matters: Rethinking the Resource Curse in Sub-Saharan Africa*, Working Papers Global and Area Studies (Hamburg: German Overseas Institute, 2005), 15-17.

84 Michael J. Watts, "Resource curse? Governmentality, oil and power in the Niger Delta, Nigeria," *Geopolitics* 9, no. 1 (2004), 50-80.

85 See Jeffrey D. Sachs, *Resource Endowments and the Real Exchange Rate: A Comparison of Latin America and East Asia*, Seventh Annual East Asian Seminar on Economics, Hong Kong, 19 June 1996. For an early presentation of Dutch Disease in the economics literature see W.M. Corden and J. Neary, "Booming Sector and De-industrialisation in a Small Open Economy," *Economic Journal* 92 (December 1982), 825-848.

86 A number of the more influential studies on this phenomenon in the 80s and 90s include Alan Gelb and Associates, *Oil Windfalls: Blessing or Curse?* (New York: Oxford University Press, 1988); Richard M. Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis* (London: Routledge, 1993); Jeffrey D. Sachs and Andrew M. Warner, "Natural Resource Abundance and Economic Growth," *Development Discussion Paper No. 517a*, (Cambridge: Harvard Institute for International Development, 1995).

Finally, there exists influential literature explaining the links between oil and other minerals, and the likelihood of civil wars and separatist conflict. This case has been made particularly with respect to the presence of oil and diamonds in many of sub-Saharan African conflicts, especially in the 1990s (Nigeria, Angola, Liberia, Sierra Leone, Democratic Republic of the Congo). Pacific observers and analysts point to the major role of the Panguna copper mine in stimulating and prolonging the long and destructive civil war in Bougainville, and the role that the Freeport mine has played in the continuing political tragedy of West Papua.⁹³

ESCAPING THE CURSE: THE TRANSPARENCY SOLUTION

Given that some emerging economies, namely Botswana, have been able to harness their natural resource wealth in positive ways, it is clear that evading the resource curse is theoretically possible.⁹⁴ If natural resource exploitation does not inherently condemn a country to poverty and violence, then what can countries do to escape the resource curse?

A broad consensus holds that transparency is the best way to inoculate against the resource curse. The concept of transparency has resonated in both popular and academic currents. The focus on transparency allows the resource curse theory to appeal to two diverse sets of constituencies. For those on the right, who argue that too much state is the problem, it can be used to question the central role of the state in development. Those on the left find validation in the tendency of this approach to emphasise the role of democratic accountability and anti-corruption.

The World Bank and many civil society organisations have lined up behind the belief that more transparency is the answer.⁹⁵ The civil society push for transparency has perhaps been best symbolised by the launch of the worldwide Publish What You Pay campaign in 2002. The campaign was at least partly responsible in provoking an official response, the Extractive Industries Transparency Initiative (or EITI). However, Publish What You Pay has long maintained that the EITI does more to require governmental transparency than transparency by companies.

93 Michael Ross, 'What do we know about Natural Resources and Civil War', *Journal of Peace Research*, Vol.41, No. 3, (May 2004) p. 343. For reference to the role of the Bougainville mine see Anthony J. Reagan, 1998. 'Current Developments in the Pacific: Causes and Course of the Bougainville Conflict', *Journal of Pacific History* 33(3): 269-285. For reference to the Panguna mine see Terence Wesley-Smith, 1992. 'Development and Crisis in Bougainville: A Bibliographic Essay', *Contemporary Pacific* 4 (2): 407-433.

94 Although Botswana has achieved success in materialising economic growth through exploitation of natural diamond reserves, this picture is tainted somewhat by the fact groups of San (former hunters-and-gatherers) have taken legal action against the Government of Botswana, claiming they were being forcibly removed from the Central Kalahari Game Reserve in order to make way for diamond mining.

95 Three of the most notable examples of civil society reports that came out in the early-mid 1990s include: Ian Gary and Terry L. Karl, *Bottom of the Barrel: Africa's Oil Boom and the Poor* (Catholic Relief Services, 2003), <http://www.crsprogramquality.org/storage/peacebuilding/Bottom%20of%20the%20barrel.pdf>; Global Witness, *A Time For Transparency: Coming Clean on Oil, Mining, and Gas Revenues*, March 2004, http://www.globalwitness.org/sites/default/files/pdfs/oil_061.04.04.pdf; Open Society Justice Initiative, *Legal Remedies for the Resource Curse: A Digest of Experience in Using Law to Combat Natural Resource Corruption* (New York: Open Society Institute, 2005), http://www.soros.org/initiatives/justice/articles_publications/publications/remedies_20050906/legalremedies_20050906.pdf.

PETRO-CAPITALISM AND THE OIL COMPLEX

Some analysts would reject outright the concept of the resource curse, and therefore question whether the push for transparency is a useful one. For example, 1970s structuralist critiques of development argued that opportunities for countries to become wealthier by graduating from a reliance on natural resource dependence to more diversified economies were only applicable to a small handful of countries.⁹⁶ Similarly, some contemporary political economists argue that the resource curse effects are the same outcome described by dependency theorists in the 1950s and 60s as 'the underdevelopment of development'.⁹⁷ Further, 'de-globalisation' theorists argue that reliance on resource extraction is simply one facet of the dependent position of poorer states in the global economy; they argue that de-linking and localising economies is the best way to spur development.⁹⁸

There is, however, something of a middle ground position on transparency. This position holds that whilst transparency is helpful in addressing the problem, it cannot alone be purported to solve it, since: 1) states that become resource dependent are already weak to begin with; and 2) the depth of the dysfunction can only be understood if seen in light of the way in which resource dependence intertwines with and distorts pre-existing social and political institutions into ever more dysfunctional entities. In other words, resource reliance introduces primary commodity capitalism into pre-existing political and cultural contexts and re-configures them in profound and perhaps intractable ways.

This position finds its best expression in the work by Nigeria expert and scholar of the political economy of oil, Michael Watts.⁹⁹ Watts defines 'petrocapi-talism' as the political economy of a particular sort of state system, a petro-state, which according to Watts, is 'dominated [...] by revenue flows and the political



Bougainville 2012. Photo credit: Antony Loewenstein.

96 The classic text on the dependency theory perspective is Andre Gunder Frank, "The Development of Underdevelopment," *Monthly Review* 18 (1966), <http://polisci.osu.edu/faculty/rwliddle/class/2007/Spring/PS741/1966-Frank-Development%20of%20Underdevelopment.pdf>.

97 Mako Kuwimb, A critical study of the resource curse thesis and the experience of Papua New Guinea (PhD thesis, 2010). James Cook University. <http://eprints.jcu.edu.au/11667/2/02Whole.pdf>.

98 For example, Kuntala Lahiri-Dutt argues that small-scale exploitation of natural resources can be a valuable source of income and livelihood for local communities, and it is the industrial-scale exploitation of them, often involving multinational companies, that can turn them into a curse: Kuntala Lahiri-Dutt, "May God Give Us Chaos, So That We Can Plunder": A critique of 'resource curse' and conflict theories," *Development* 49, no. 3 (2006), 14-21.

99 See Watts, op. cit.; Michael J. Watts, "Righteous Oil? Human rights, the Oil Complex, and Corporate Social Responsibility," *Annual Review of Environmental Resources* 30 (2005), 373-407.

mechanisms by which oil revenues are absorbed, distributed, and spent'.¹⁰⁰ Such an arrangement is undergirded by the unity of a firm, state and community (an 'oil complex') that is territorially constituted through oil concessions. Watts describes the 'oil complex' in Nigeria as: 1) a statutory monopoly over mineral exploitation; 2) a nationalised oil company; 3) the security apparatus of the state (which works hand-in-glove with that of the companies); and, 4) an institutional mechanism by which federal oil revenues are distributed to the states and producing communities.¹⁰¹ The system generates substantial unearned income and has centralising effects on the state, and thus the entire political system is transformed by the oil revenues.

This transformation of the political realm occurs in parallel with - and is enhanced by - an accompanying transformation of the socio-cultural realm:

The presence and activities of the oil companies as part of the oil complex constitute a challenge to customary forms of community authority, inter-ethnic relations and local state relations principally through property and land disputes that are engendered, via forms of popular mobilisation and agitation. These political struggles are animated by the desire to gain access to (i) company rents and compensation revenues (ii) federal petro-revenues by capturing rents (often fraudulently) through the creation of new regional and /or local state institutions. The oil complex (as a static and institutional description) and petroculturalism (as a dynamic set of forces) reconfigures differing sorts of governable spaces in which contrasting sorts of identities and forms of rule come into play.¹⁰²

Watts argues that under petroculturalism the immense weight and influence of the oil complex gradually reconfigures not only the entire economy and the political system, but also most forms of political and ethnic identity as well. Watts' work extends the theory of resource dependence into new dimensions, and presents a fundamental critique of the limitations of the resource curse thesis.

PNG: A GAS COMPLEX?

Do Watts' characterisations of an oil complex accompanied by petro-capitalism have relevance for our consideration of PNG? To phrase the question another way, is PNG on the path to developing a 'gas complex'? To answer these provocative questions, we make the following observations:

- 1) The growing importance of the energy sector must now be added to the historically deep penetration of mineral and forestry companies into the PNG economy. Now that PNG LNG is progressing, other petroleum companies are also moving in,¹⁰³ and ExxonMobil itself is already looking to explore other

potential gas reserves on concessions, including that owned by Australian mining billionaire Clive Palmer.¹⁰⁴

US Secretary of State Hilary Clinton's recent comments to the Congressional Foreign Relations Subcommittee (noted in the Introduction) frame PNG as a potential regional battleground for the development of energy projects. Such a remark is important precisely because it casts light on the way in which powerful international energy interests see PNG: as the site of a huge energy find and thus a pawn to be exploited in a great power rivalry. Presumably, Secretary Clinton was aware that the LNG in this case is being sold to Asia, thus the characterisation of PNG as a site for US/China 'competition' may not relate to the question of energy security as such, but more likely refer to the competition over control of the global energy market as a way of maintaining US global dominance and securing business for its corporations.¹⁰⁵

- 2) As we see in greater detail in the subsequent Chapters, PNG is in the process of strengthening the structure and governance of its state-owned energy companies, most notably MRDC and Petromin. Whilst modest in size compared with those of Indonesia, Venezuela, Nigeria, and Iran, PNG's state-owned petroleum companies are following the model of the oil complex by going into joint ventures with international majors, thereby entwining state institutions in resource-extraction and petro-politics.



Port Moresby Airport 2012. Photo credit: Antony Loewenstein.

- 3) There is in PNG an unfolding process by which ethnic identities have become entwined with the political economy of resource revenues, which is a central aspect of the phenomenon of petro capitalism. The process by which landowner institutions have become irreconcilably altered by their interaction with the desire to acquire resource 'rents' is perfectly captured by academic Colin Filer. Compensation, in this conception, amounts to:

100 Michael Watts, op. cit., "Righteous Oil?," http://globetrotter.berkeley.edu/GreenGovernance/papers/Watts_RighteousOil.pdf, 9.12.

101 Watts, op. cit., "Resource Curse?," 60.

102 Watts, op. cit., "Resource Curse?," 54.

103 "Shell believes that PNG is under-explored and the country offers potential for development. We are very keen to invest and develop business opportunities in PNG," said Shell's Vice-President for Commercial Development in Asia, upon the opening of the company's new office in Port Moresby. See Christine Forster, "Shell opens office in PNG in search of LNG opportunities," Platts, 9 February 2012, <http://www.platts.com/RSSFeedDetailedNews/RSSFeed/NaturalGas/7172019>.

104 "Palmer mulls Exxon deal," Australian Financial Review, 6 February 2012, http://www.afr.com/p/national/palmer_considers_png_deal_with_exxon_V9QFZXRPFdEkOAPRbu9RZP.

105 Consider as evidence Clinton's comments in the same interview: "They're supporting the dictatorial regime that unfortunately is now in charge of Fiji ... They have brought all of the leaders of these small Pacific nations to Beijing, wined them and dined them. I mean, if anybody thinks that our retreating on these issues is somehow going to be irrelevant to the maintenance of our leadership in a world where we are competing with China, that is a mistaken notion." Jemima Garrett, "US Flags fight for PNG resources," The World Today (ABC Radio), 7 March 2011, <http://www.abc.net.au/worldtoday/content/2011/s3157026.htm>.

the state of equilibrium reached when [the] forces of destruction and impact must [be] equal to the forces of compensation ...[so that] the Landowners are forever happy and accept the losses and impact they will suffer.¹⁰⁶

Or to put it another way, local communities are only 'summoned into being or defined as such by the presence or the potential presence of a mining project'.¹⁰⁷

4) There is a tradition in PNG of expressing through Project disruption frustrations about the adverse effects and unmet expectations of resource projects. Whilst this has most clearly been demonstrated in the decade-long civil war in Bougainville, other mining sites have been the locations of lower-intensity conflict over the lesser spoils of mining projects.

5) The way in which the security apparatus under the direct or indirect control of the state have become involved in the process of protecting the natural resource wealth from claims by local communities has also been witnessed in PNG's recent history, again most notably in the decade-long civil war in Bougainville.

While there are, of course, significant differences between the political economy of PNG and that of Nigeria and other states with an 'oil complex', the fact remains that PNG LNG is poised to transform PNG's political, economic and social life in profound ways. Although there are limitations in applying an analysis of the Nigerian case to PNG, Watts' work should be kept in mind for the Chapters to follow, especially insofar as they consider the capacity of PNG's institutions to resist falling ever-deeper into the negative embrace of resource dependency.

SUMMARY FINDINGS

The PNG economy is resource dependent, has a high degree of foreign ownership and a large informal economy. The traditional strength of the agricultural sector has been challenged by the growing role of mining, and now, oil and gas. These latter two sectors have long provided most of PNG's foreign exchange. The volatility of the economy in the 1990s, due partly to poor management of its resource revenues, has settled in recent years. But the slight reduction in poverty, which is most widespread in rural regions, has not been helped by the mining sector.

- The governance and public life of PNG are to this day beset by political intrigue, self-interest of politicians, and gross misuse of public funds.
- Connections to land still play the dominant role in PNG cultural life, and wantok kinship networks remain the strongest identities of the PNG people. The tension between kinship and land connections on the one hand, and modernisation and development on the other, are reflected in political contradictions that seem to grow ever-more entrenched.
- The mining sector has often been at the centre of these tensions, as best represented by the

destructive conflict on the island of Bougainville in the later 1980s and 1990s.

- There exists a great deal of academic literature on the connection between natural resource abundance and (1) poor levels of economic development, (2) weak democracy and human rights' protection, and (3) internal conflicts and civil wars.

A strong political push in recent years has attempted to address the natural resource related problems by proposing greater revenue transparency. While necessary, transparency may not be sufficient to address the more intractable problems related to resource dependence, including the way in which the political and cultural roles of indigenous groups become transformed by, and bound up with, the desire to access resource revenues.

¹⁰⁶ Filer, op. cit. "Local Custom", 141.

¹⁰⁷ Ballard and Banks, op. cit., 297.

2 THE PROJECT AND THE PLAYERS

This Chapter begins with a brief overview of the PNG LNG Project itself (referred to in this Report as 'the Project'), followed by a discussion of the international actors involved in PNG LNG, including the companies, the purchasers, and the institutions providing finance. The role of export credit agencies and foreign governments is given particular attention. The Chapter then looks at the various roles held by the PNG Government in the Project: as an equity holder, as the author of PNG's minerals and petroleum policy, and as sovereign negotiator with the companies regarding the terms of the deal. The Chapter concludes with a discussion of the PNG LNG landowners: it outlines which groups are 'landowners' with respect to the Project, what their social and cultural dynamics are, and what the negotiations over PNG LNG reveal about their expectations.

2.1 THE PNG LNG PROJECT

For many years a number of major petroleum companies have pursued the commercialisation of the vast wealth of gas reserves in the Southern Highlands region of PNG.¹ The most recent was ExxonMobil's scheme to run a gas pipeline from the region to Queensland, a plan that was abandoned in 2006 following the declaration that year of a state of emergency by the National Government in the then Southern Highlands Province.² Despite this setback, by late 2009, after several years of negotiations, ExxonMobil and its partners managed to strike a deal with the PNG Government. In March 2010, financing for the deal was secured, along with the long-term sales contracts to the buyers.³ The result was a green light for PNG's largest industrial Project and the largest private sector investment ever contemplated in the Pacific region.

INVESTMENT AND INFRASTRUCTURE

As of November 2012, the total cost of constructing the ExxonMobil-led Project is estimated to reach \$US19 billion (K39 billion), a blow-out from the previous stated Project cost of \$US15.7 billion. As business sources have reported, the increase in costs is 'another disconcerting sign that construction costs in the region are eroding the economics and competitiveness of resource projects'.⁴

The construction phase of the Project began in 2010 and is still predicted to be on track to be completed before 2015. It involves the development of the infrastructure necessary for new production and processing facilities in both Hela Province and in Western Province, an onshore and offshore gas pipeline, and a liquification plant at Caution Bay, near Port Moresby. Other Provinces that are affected are the Western, Gulf and Central Provinces. Most of the gas wellheads will be located within the newly-created Hela Province.⁵

The project also draws upon infrastructure already existing in the Kutubu Oil fields, which lie in the southern lowlands of the Southern Highlands Province. A list of the new infrastructure for the Project is given in Table 1.

Although there have been some accounts that the Project is behind schedule in some areas, in March 2012 it was reported that the LNG plant at Caution Bay was 30 per cent complete, and that Komo airport was half-way to completion.⁶



Work underway on the road outside Tari 2011.
Photo credit: James McIlraith/ University of Otago.

OPERATION AND OUTPUT

PNG LNG is expected to produce approximately 6.6 million tonnes of LNG per year.⁷ The gas is estimated to begin flowing in 2014 and to continue for almost 30 years, until 2042. Although the Project is substantial in terms of costs,⁸ there are several other LNG projects

¹ In 1995 Chevron Asiatic Ltd proposed commercialising gas or oil fields at Kutubu, Gobe, Agogo and Moran and exporting the gas by pipeline to Australia. In 2004 Esso Highlands pursued a similar proposal, with a pipeline to the Australian market. See Coffey Natural Systems, "Environmental Impact Statement: PNG LNG Project (2008)", 4-5. The 2004 proposal largely fell through due to factors inherent in the natural gas market in Australia.

² "State of Emergency in PNG Region," BBC News, 1 August 2006, <http://news.bbc.co.uk/1/hi/world/asia-pacific/5234580.stm>.

³ "Financial Close for PNG LNG," Project Finance, 15 March 2010, <http://www.projectfinancemagazine.com/Article/2469850/Financial-close-for-PNG-LNG.html>.

⁴ Stephen Bartholomeusz, "Gas construction costs dangerously overheating", Business Spectator, 12 November 2012: http://www.businessspectator.com.au/bs.nsf/Article/gas-oil-shale-exxon-santos-PNG-LNG-dollar-pd20121112-ZY9JA?opendocument&src=idp&utm_source=exact&utm_medium=email&utm_content=132270&utm_campaign=kbg&modapt=commentary

⁵ The Hela Region became its own Province, splitting from the Southern Highlands Province, in May 2012 - see section 2.4.

⁶ "LNG Plant 30% complete," The National, 15 March 2012, <http://www.thenational.com.pg/?q=node/30261>; "Airstrip at Komo 50% done," The National, 15 March 2012, <http://www.thenational.com.pg/?q=node/30261>.

⁷ See PNG LNG Project website: <http://www.pnglng.com/project/index.htm>.

⁸ PNG LNG costs will nevertheless be dwarfed by those of the Gorgon Liquefied Natural Gas (LNG) Project being developed in Western Australia for around \$AU43 billion. See Anonymous, "The Gorgon LNG Project," Australian Business Journal (January/February 2011), <http://www.australianbusinessjournal.com.au/the-gorgon-lng-project/>. Construction costs are closer in size to the Sakhalin II Oil and Gas Project in the Russian Far East, which have been estimated at around \$US20 billion. See Sisgeo, Sakhalin II Project, www.sisgeo.com/wp-content/uploads/2011/03/Sakhalin_project_II.pdf.

PNG LNG INFRASTRUCTURE

| INFRASTRUCTURE AND PURPOSE | LOCATION |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------|
| Construction of new production facility to collect both liquids and gas before transport to the Hides conditioning plant | Juha |
| Construction of new Gas Conditioning Plant to receive gas from the Hides, Angore and Juha gas fields | Hides |
| Upgrade of existing oil production facilities to allow gas treatment to LNG specifications, and connection of existing fields to the main LNG onshore pipeline. | Agogo, Kutubu and Gobe |
| 284 km pipeline between Hides and Kopi to transport gas from the Southern Highlands to the Coast. Construction of new pipelines linking new and existing gas fields and production facilities at Juha, Hides, Angore, Agogo, Kutubu, South East Hedinia and Gobe. | Onshore |
| 407 km pipeline to transport gas across Gulf of Papua to Caution Bay | Offshore |
| Construction of LNG processing and liquefaction plant to process, compress, refrigerate and store the gas for future sale. Construction of an LNG export jetty and materials offloading facility adjacent to the LNG plant, for international transport of gas. | Caution Bay (Port Moresby) |

Table 1: Project infrastructure (Source: PNG LNG Social Impact Assessment 2008).¹

¹ From Lawrence Goldman, Papua New Guinea Liquefied Natural Gas Project Social Impact Assessment 2008, http://www.pnglng.com/media/pdfs/environment/eis_appendix26.pdf, January 2009, 1-6.



Figure 2: PNG LNG Overview Map (Source: ExxonMobil - Reproduced with permission).

in the Asia region which are larger in output than PNG LNG, including the Bontang, Petronas and Sakhalin II Projects. Over the 30 year project life, total value of oil and gas output is predicted to be between K200 billion⁹ (\$US55 billion) and K443 billion (\$US123 billion).¹⁰

BOX 2.1: WHAT IS LNG?

Liquefied Natural Gas (LNG) is the liquid form of natural gas (mostly methane) which has been cooled to its liquid state at extremely low temperatures. LNG is colourless, odourless and non-toxic and is stored at atmospheric pressure in specially-designed onshore tanks and transported to international markets in specially designed ships.

To convert natural gas into liquid form, the gas is super-chilled to -160 °C. At this very cold temperature, the gas becomes a liquid, occupying about 600 times less space. Once shipped to its overseas destinations, LNG is warmed or 're-gasified'. It can then be transported by existing pipelines and used as fuel for industry, electricity generation, and in homes for heating and cooking.¹¹

LNG accounts for 30.5% of global gas trade, the balance being made up of pipeline gas.¹² In 2005, Indonesia was the world's largest LNG exporter, a position the country had held since 1984. However, by 2006, Qatar overtook Indonesia as the largest LNG supplier in the market, delivering in 2010 more than a quarter of the world's production. Indonesia, Malaysia and Australia are currently the next largest producers, supplying in 2010 a combined 29% of the world's production.¹³ In the longer term, Australia is projected to surpass Qatar as the largest LNG exporter. Australia has a significant volume of capacity under construction - 36.05 Million Metric Tonnes Per Annum (MMtpa) - a vast amount, which dwarfs the 6.6 MMtpa expected to be produced over the life of the PNG LNG Project.¹⁴

2.2 THE OUTSIDE ACTORS

Undertakings of PNG LNG's scale inevitably involve the formation of joint ventures between a number of corporations. Together four joint venturers, the financial institutions backing them (government, semi government and private) and the buyers, all discussed

9 Under the low commodity price scenario, ACIL Tasman, op. cit., 11.

10 Under a high commodity price scenario. The case study scenario adopted by ACIL Tasman is \$US95 billion, *Ibid.*, 11.

11 Adapted from PNG LNG Promotional Material, Energy for the World. Opportunity for Papua New Guinea, http://www.pnglng.com/media/pdfs/publications/pnglng_brochure_2009.pdf

12 British Petroleum, BP Statistical Review of World Energy June 2011, http://www.bp.com/assets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2011/STAGING/local_assets/pdf/statistical_review_of_world_energy_full_report_2011.pdf, 4.

13 International Gas Union, World LNG Report 2010, <http://www.igu.org/igu-publications-2010/IGU%20World%20LNG%20Report%202010.pdf>.

14 *Ibid.*

below, make up the international actors in the PNG LNG Project. While the four foreign companies together own approximately 80 per cent of the Project equity, the remaining 20 per cent is owned by the PNG Government and landowners, discussed in Sections 2.3 and 2.4 below.

THE PROJECT OPERATOR - EXXONMOBIL CORPORATION¹⁵

Esso Highlands Ltd (EHL), a wholly-owned subsidiary of ExxonMobil, serves as the PNG LNG operator and manager. Esso Highlands enjoys the largest equity share in the joint venture, with 33.2 per cent. Furthermore, it is providing \$US3.75 billion towards the Project financing.

Although recently surpassed by PetroChina, ExxonMobil has for some time been the world's largest supplier of publicly traded oil, reportedly producing 2.3 million barrels of oil a day. With 2011 revenues recorded at \$US355 billion, it has been ranked by Fortune magazine as the world's third richest corporation.¹⁶

The multi-national has a long and controversial history in the global oil and gas sector.¹⁷ In particular, many associate Exxon with the 1989 Exxon Valdez oil spill in Alaska's Prince William Sound, when an Exxon oil tanker hit a reef and spilt over 1.2 million barrels of oil, killing thousands of marine animals and decimating key fishery industries.¹⁸ Exxon's history in oil and gas development has also been subject to allegations of complicity in serious human rights abuses in relation to the Arun LNG Project in Aceh, Indonesia.¹⁹ ExxonMobil's participation in the Chad Cameroon Pipeline has also been criticised for ignoring social and environmental costs.²⁰

15 For an overview of current ExxonMobil projects and financial position see Exxon Mobil, 2010 Annual Summary Report (2010), http://www.exxonmobil.com/Corporate/Files/news_pubs_sar_2010.pdf.

16 Fortune ranked it behind Wal-Mart and Royal Dutch Shell, "Global 500 2011," CNN Money, http://money.cnn.com/magazines/fortune/global500/2011/full_list/index.html.

17 It is appropriate to note that Exxon and Mobil did not merge until December 1998. For an overview of current ExxonMobil projects and financial position see Exxon Mobil, op. cit..

18 Jenny Mead, Edward Freeman, Andrew Wicks and Patricia Werhane, ExxonMobil and the Chad/Cameroon Pipeline, Darden Case No. UVA-E-0262 (2003), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1278357. See also Greenpeace, Exxon Valdez disasters - 15 years of lies (2004), <http://www.greenpeace.org/international/en/news/features/exxon-valdez-disaster-15-year/>; ExxposeExxon, The Exxon Valdez Oil Spill Exxposed: A Reality Check on ExxonMobil's claims (2007), <http://www.exxposeexxon.com/facts/Valdez.html>.

19 Local Aceh citizen claimants have argued in legal suits that Mobil hired military units of the Indonesian National Army to provide "security" for their gas extraction and liquification project in Aceh, Indonesia and have accused these security forces of serious human rights abuses. See Complaint for Equitable Relief Damages in the United States District Court for the District of Columbia, 11 June 2001, <http://www.iradvocates.org/exxoncomplaint.pdf>. See also International Rights Advocates, John Doe vs. Exxon Mobil Corporation, Exxon Mobil Oil Indonesia Inc., Mobil Corporation, and PT ARUN LNG Co., 11 June 2001, <http://www.iradvocates.org/exxoncase.html>. ExxonMobil has denied the allegations made by the claimants. See "Exxon Mobil Denies Human Rights Charges," ISIS News, 9 July 2001, <http://www.icis.com/Articles/2001/07/09/142477/exxonmobil-denies-human-rights-charges.html>.

20 See Akong Charles Ndika, "Chad-Cameroon pipeline: unblurring the mirage of black gold," Africa Files, <http://www.africafiles.org/article.asp?ID=5063>.

- ExxonMobil (Esso Highlands Ltd)
- Oil Search Ltd
- Santos Ltd
- JX Nippon Oil & Gas Exploration Cop
- Government of the State of PNG

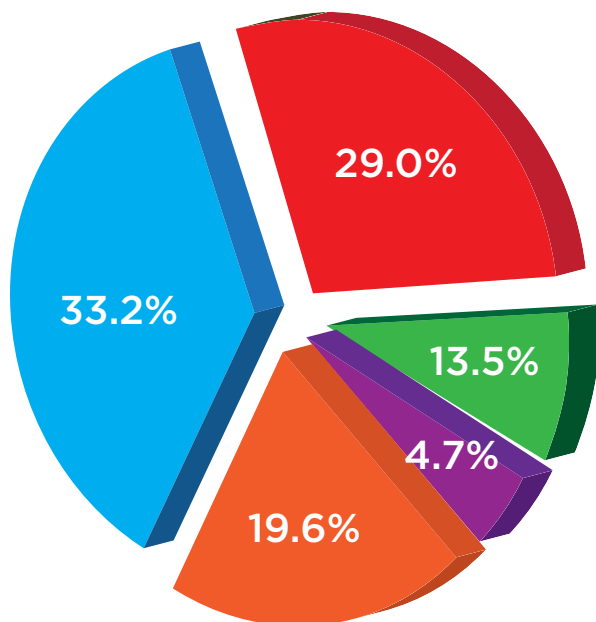


Figure 3: PNG LNG Joint Venturers - Equity breakdown

THE OTHER PRIVATE JOINT VENTURE PARTNERS

ExxonMobil is joined by a number of other players that have a direct equity stake in the Project. ExxonMobil, through EHL, and the other partners outlined below, hold approximately 80 per cent of the total equity in the Project, with the remainder held by the PNG Government and Landowners.

Oil Search Limited

The next most significant equity holder after EHL, with 29 per cent, is Oil Search Ltd, a PNG-based company. It is the largest oil and gas producer in PNG with substantial stakes in the Kutubu, Moran, Gobe and SE Mananda oil fields, all of which are part of the Project (refer to Figure 2).²¹ Although the PNG Government has a 17.6 per cent shareholding in Oil Search through the government-owned Independent Public Business Corporation,²² Oil Search is listed on the Australian Stock Exchange (ASX) and is predominantly Australian-owned and -operated.

Oil Search has had a long presence in PNG and is the only equity partner with considerable experience in

²¹ For details of existing stakes in oil field projects see Oil Search Limited, Our Activities, <http://www.oilsearch.com/Our-Activities/PNG/Kutubu.html>.

²² The IPBC's interest in Oil Search is an exchangeable bond - it is unknown whether this arrangement grants it any voting rights in the company.

PNG's oil and gas sector. Its history in PNG, however, is not without controversy. Locals who live near Lake Kutubu claim that contamination from the nearby Kutubu oilfields has resulted in serious health impacts, although Oil Search has denied these allegations.²³

Santos Limited

Santos Ltd is a major Australian oil and gas producer listed on the ASX with a market capitalisation of \$AU13 billion.²⁴ Santos' involvement appears to be an investment decision with 13.5 per cent equity in the Project. Santos has considerable interests in natural gas and coal seam gas production and processing infrastructure, and the company has a number of conventional 'gas plays' in the Asia Pacific. Its historical investment in PNG LNG production licence areas relates to earlier proposals to pipe LNG from the Southern Highlands to Queensland.

JX Nippon Oil and Gas Exploration Corporation

JX Nippon Oil and Gas Exploration Corporation is an oil and gas exploration and production company that forms part of the JX Holdings Incorporated Group.²⁵ The company has an interest in the Kutubu and Moran oil fields via its subsidiaries Japan Papua New Guinea Petroleum Company and Nippon Oil Exploration (Niugini) Ltd.²⁶ It owns a 4.7 per cent equity stake in the Project.

These four joint venturers - ExxonMobil, Oil Search, Santos, JX Nippon Oil and Gas Exploration Corporation - are in this Report referred to as 'the Companies' (in other documentation they are known, along with the relevant PNG Government agencies, as the 'Joint Venturers').

CORPORATE SOCIAL RESPONSIBILITY

In the lead-up to the initiation of PNG LNG, ExxonMobil and its partners commissioned a number of studies to ascertain the expected impact of the Project on the PNG economy, environment and society. Consultants ACIL Tasman were employed to produce the 2008 Economic Impact Statement which made projections about the economic impacts of the Project. This report will be the focus of the next Chapter. Other important assessments commissioned by the Companies were the Environmental Impact Statement and the associated Social Impact Analysis (SIA).²⁷ The production of these materials, and the use of experts to assist with land ownership and compensation,²⁸ is in line with the type of due diligence expected for such a project under voluntary international standards.

²³ Jubilee Australia, *Risky Business* op. cit., 35.

²⁴ For an outline of PNG exploration acreage see Santos, Papua New Guinea and West Papua, <http://www.santos.com/exploration-acreage/papua-new-guinea-west-papua.aspx>.

²⁵ See JX Holdings, Inc., <http://www.hd.jx-group.co.jp/english/>.

²⁶ See JX Nippon Oil and Gas Exploration, Papua New Guinea, <http://www.nex.jx-group.co.jp/english/activity/oceania/png.html>.

²⁷ PNG LNG Project Environmental Impact Statement, 23 January 2009, http://www.pnglng.com/commitment/environmental_impact_statement.htm. The Social Impact Analysis was completed by University of Queensland Anthropologist Laurence Goldman, and can be found in Appendix 26 of the Environmental Impact Statement, http://www.pnglng.com/media/pdfs/environment/eis_appendix26.pdf.

²⁸ The companies have commissioned anthropological experts to assist with the mapping of affected communities to assist with compensation claims for compulsory resettlement and to assist with the process of identifying beneficiaries for revenue streams.

In addition to these actions, the Companies have initiated their own social programs in the country. Oil Search recently launched its Health Foundation, which will contribute \$AU24 million (K48 million) into health services in nine of PNG's Provinces, employing 80 people.²⁹ The PNG LNG Project has itself financially supported a range of CSR projects focussed on education, health, agriculture and empowerment of women. According to ExxonMobil, these initiatives 'are based on targeted research and analysis, including community mapping, livelihood assessments and assessments of local industries and existing community development institutions.'³⁰ They include education programs in more than one hundred elementary schools, environmental internships, training programs, sporting equipment, and financial contribution towards a public library.³¹ For more details on ExxonMobil's CSR activities see Appendix 1.

THE BUYERS

As noted earlier, the Project is expected to produce 6.6 million tonnes of gas per year. Essentially all of this output is already locked into contracts to be sold to various energy suppliers in Japan, China and Taiwan (see Figure 4 for details of the agreements).

Agreements signed by the buyers are called 'take-or-pay' agreements, meaning that the buyer is obliged to pay for a certain percentage of the contracted quantity even if the buyer fails to take the LNG offered by the seller. From the seller's perspective, take-or-pay provisions help guarantee a predictable minimum cash flow.

THE PROJECT FINANCIERS

The PNG LNG financing deal has been described as the world's largest project finance agreement for the energy sector.³² The financing raised for the Project has been provided by a syndicate of 6 Export Credit Agencies (ECAs), contributing a total of \$US8.3 billion, 17 commercial lenders (European, Asian and Australian banks) providing a total of \$US1.95 billion and ExxonMobil itself contributing \$US3.75 billion.³³

THE EXPORT CREDIT AGENCIES

Five major ECAs from the US, Japan, China, Italy and Australia provide 60 per cent of the financing toward the Project. A sixth agency, Nippon Export and Investment Insurance, only provides insurance against political and economic risks. See Figure 5 for details about the nature of ECA involvement. The sums given towards PNG LNG represent the largest financial contributions ever given to a single project for a number of the participating ECAs—including USA's Ex-Im and Australia's EFIC.

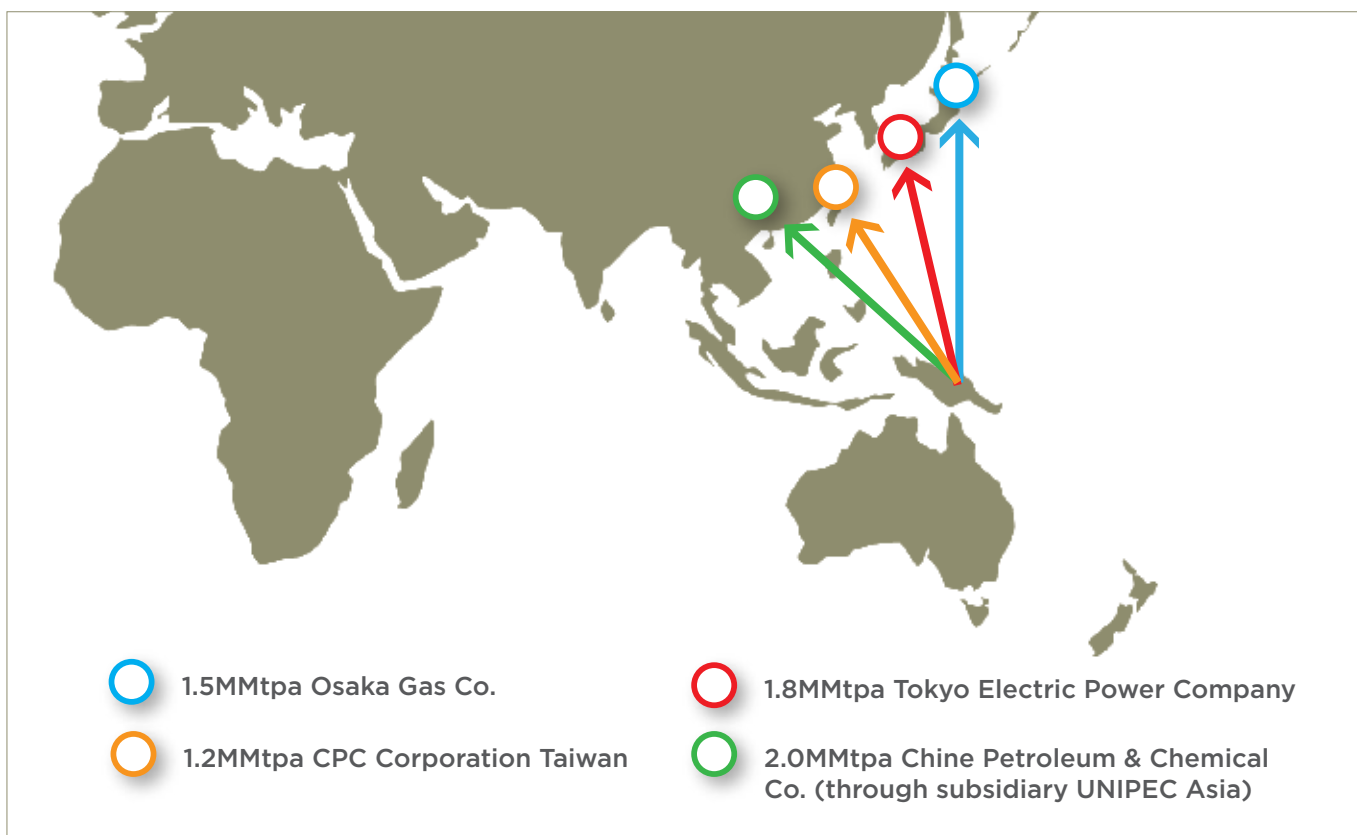


Figure 4: The buyers (million metric tonnes per annum, over 20 years).

29 Malum Nalu, "PM calls on Investors to Show Commitment, The National, 29 March 2012, <http://www.thenational.com.pg/?q=node/30845>.

30 Letter from ExxonMobil, 12 June 2012 (see Appendix 1).

31 Media Releases giving details of these CSR projects supported by PNG LNG/ EHL are listed on the PNG LNG Project Website: <http://pnglng.com/media/mediarelease.htm>.

32 ExxonMobil "PNG LNG Project Financing" US Ex-Im Annual Conference 11 March 2010," <http://www.docstoc.com/docs/56919069/PNG-LNG-Project-Financing>, 7.

33 See Steve Kane, PNG LNG Financing: A major achievement (ExxonMobil, 6 December 2012), http://www.pnglng.com/media/pdfs/speeches/PNG_LNG_Financing_Presentation_Steve_Kane_Dec_6_2010.pdf, 4.

The involvement of this collective of ECAs has some key implications for the Project. First, it is a boon for the companies for a number of reasons. Most importantly, accessing private finance becomes easier for the companies once they have ECA support because financial interest from public institutions/governments lessens the perceived risk for private financiers.³⁴ ECA involvement ensures that powerful overseas governments develop a strong interest in, and incentive for seeing that the Project is a financial success. This diplomatic support and 'know how' invested in ECA projects gives companies extra security and peace of mind. The influence of powerful governments is enhanced when they are aid donors, as Australia,³⁵ Japan and China are for PNG. Although this leverage is primarily of benefit to the governments involved, it can be a further source of reassurance for the companies and the financiers.

impacts of projects against the International Finance Corporation's (IFC) Performance Standards.³⁷ However, as was referred to in Chapter 1 of Jubilee Australia's *Risky Business* report, ECAs have been serial offenders when it comes to enforcement of their own standards, especially with regard to large extractive projects.³⁸ Nevertheless, their (and private banks') involvement has at least tightened the reporting for PNG LNG. The initial Environmental Impact Statement documentation for the Project, which was geared towards compliance with PNG's less rigorous domestic legal requirements, possessed relatively weak social and environmental management plans.³⁹ Soon after the consortium of PNG LNG financiers came together, they quickly hired an independent consultant, the Italian-based D'Appolonia, to do regular reporting to them on social and environmental impacts.⁴⁰ This action from the consortium of PNG LNG lenders tied ExxonMobil

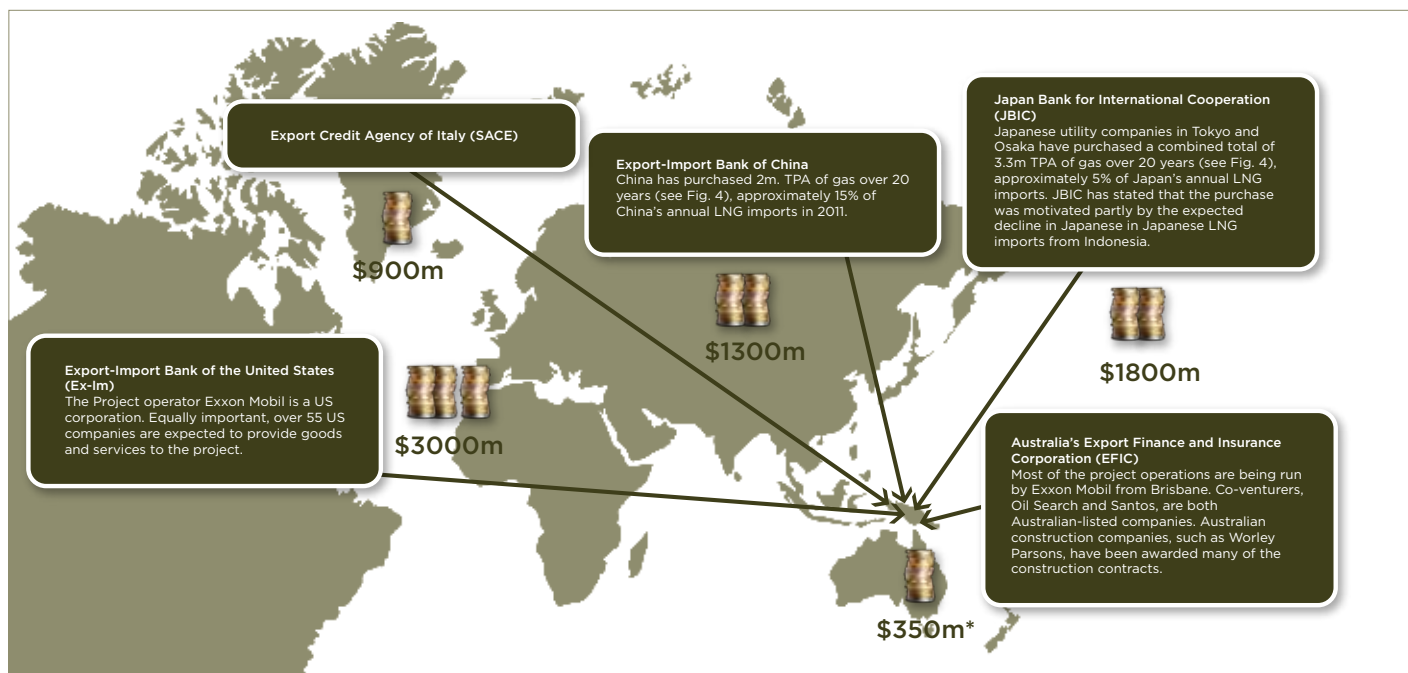


Figure 5: The Export Credit Agency financing of PNG LNG

*Note: The original agreement announced in December 2009 projected that Australia would provide up to US \$500m of Australian export credit to the Project. The final amount of the EFIC facility was US \$350m. At this date the facility is not fully drawn but it is expected to be by the completion of the Project.

Second, the involvement of the ECAs in theory has implications for how the Project operator assesses and manages the social and environmental risks associated with the Project. Under the OECD's Recommendation on Common Approaches to the Environment and Officially Supported Export Credits ('Common Approaches'), OECD ECAs have expressed their intent (though legally non-binding) to adhere to a set of principles relating to environmental safeguards.³⁶ Some ECAs (including EFIC) have gone further in agreeing to benchmark the environmental and social

to stricter requirements than those outlined in the original EIS documentation, though in effect it sees the ECAs 'outsource' the monitoring for breaches of the environmental and social management plans to this independent consultant.⁴¹

Third, ECA involvement in these sorts of projects is most often predicated on some sort of national interest, usually a commercial benefit to domestic corporations. As Figure 5 outlines, the various ECAs' involvement can generally be explained by the fact

34 Maniruzzaman makes this argument about the World Bank and the ADB, but the same principle applies to ECAs, which are state-owned corporations of official development aid providers. See A.F.M. Maniruzzaman, "The Issue of Resource Nationalism: Risk Engineering and Dispute Management in the Oil and Gas Industry," *Texas Journal of Oil, Gas and Energy Law* 5 (2009), 79-108.

35 In 2011 AusAID provided 70 per cent of total Project Grants to PNG. See PNG Government Department of Treasury, op. cit., 2012 Budget: Overview and Revenue, 42.

36 See OECD, *About Environment and Export Credits*, http://www.oecd.org/document/26/0,3746,en_2649_34181_39960154_1_1_1_100.html.

37 See International Finance Corporation, *Performance Standards and Guidance Notes*, <http://www.ifc.org/ifcext/sustainability.nsf/Content/PerformanceStandards>.

38 Jubilee Australia, op cit., 10-11.

39 While Exxon suggests that finance plans of the Project JV were based on the objective of 70/30 debt-to-equity split there is suggestion that ExxonMobil had intended to fund the whole Project (Confidential Source).

40 Up-to-date analysis of the Project's social and environmental monitoring may be found in the quarterly reports by D'Appolonia S.p.A, Independent Environmental and Social Consultant - Environment and Social Compliance Monitoring: Papua New Guinea LNG Project (2010), http://www.pnglng.com/quarterly_reports/e_s_reports.htm.

41 See comments from DFAT Representative to Australian Senate Estimates with regard to the landowners' disputes: "They are quite complicated-again, I do not pretend to understand it-and whether they amount to non-conformance with the environmental and social plan is a matter that would be assessed by D'Appolonia as the independent consultant."

that corporations from that country are either one of the Project's joint venturers, are buyers of the gas, or have been assured of some of the Project's construction contracts. Indeed, a quick look at some of the recipients of the largest construction contractors for the Project shows that they are dominated by Australian, American, Japanese and Italian contractors, all of whose countries are providing financial support through their ECAs.⁴²

This is no coincidence. ECAs are fairly explicit in connecting their offers of financial support to opportunities for their national businesses. Promotional material still currently on the EFIC website states:

EFIC's motivation for participating was to support Australian exporters in pursuing contracts for the construction phase of the Project. So far, Australian companies have been awarded or are preferred tenderers for more than \$US1 billion of work, with substantial sub-contracting opportunities also available.⁴³

We can gain further enlightenment about EFIC's support for the Project in an exchange between a Department of Foreign Affairs and Trade (DFAT) spokesperson and Senator Scott Ludlam in a Senate Estimates session in the Australian Parliament, February 2011:

Senator Ludlam: Just coming back very briefly to the LNG thing: that is a loan valued, I understand, at about half a billion dollars for ExxonMobil and other proponents. Why are we loaning money to one of the largest oil majors in the world? I am not sure how this is meant to benefit Australia exactly.

Mr Tighe: I think you would find the equity in that Project is around about 43 per cent Australian. There are also up to I think about a billion and a half dollars worth of potential Australian procurement going into the Project. It was in our interests to see that the Project was properly financed and went ahead.⁴⁴

Likewise, when American Ex-Im announced its support for the deal, it said the following:

The Export-Import Bank of the United States (Ex-Im Bank) has approved the largest financing transaction in its 75-year history—\$3 billion to support U.S. exports for a liquefied natural gas (LNG) Project in Papua New Guinea. Workers at over 55 U.S. companies will provide goods and services for the Project.⁴⁵

Little is known about how ECAs attain the inside track for their home-country contractors, whether it is through some sort of 'handshake' deal or through

commercial-in-confidence clauses in the financing contracts. But clues may be gained from a December 2010 presentation by an ExxonMobil spokesperson, who described the nature of the ECA financial arrangement for three of the ECAs as being 'on a tied basis (to potential procurement).'⁴⁶ It is thus plausible to suspect that there was some provision for the attainment of the contracts in the loan agreements.

Given Australia's key role in supporting this Project through EFIC, more detail about how the Government made the decision to finance the Project is given in Box 2.2.

BOX 2.2: PNG LNG AND AUSTRALIA'S 'NATIONAL INTEREST'

As was outlined in detail in Jubilee Australia's previous report, *Risky Business*, EFIC has two accounts: a Commercial and a National Interest Account. Approval is needed from Federal Cabinet for the Trade Minister to be able to direct EFIC to undertake a transaction on the National Interest Account, and some sort of national interest grounds must be established.⁴⁷ Due to the size and the controversial nature of the PNG LNG loan, the issue of how and why the decision to loan the money was made raised the interest of Australian Parliamentarians. Reproduced below is one such relevant exchange between Senator Scott Ludlam and the DFAT spokesperson in February 2011:

Senator Ludlam: In terms of due process around that investment, I do not know whether a national interest statement was undertaken and not published or whether it was not undertaken. Can you just clarify that for me?

Mr Tighe: The national interest process is a cabinet process. There is no such thing as a national interest statement. What there is is a submission to cabinet put together on a whole-of-government basis, which cabinet then considers and then takes a decision on whether or not to proceed with a national interest transaction proposal.

Senator Ludlam: Have you just handballed responsibility for answering that question to the government; that is a political question?

Mr Tighe: No, I think I have told you what the process is.

Senator Ludlam: I am just trying to follow your chain of logic. You put a submission up to government and government makes a call on whether to subject it to a national interest test or not.

Mr Tighe: I think the question you asked me, or just the way I interpreted it - and if

42 Major PNG LNG contractors include: Choyoda and JGC Corporations (Japanese). Clough Ltd, Curtain Bros, McConnel Dowell and Wagners (Australian), GE Oil and Gas and Saipem SpA (Italian) and CB&I (American). See for example PNG LNG Consortium, PNG LNG Quarterly Environmental and Social Report, 4th Quarter 2011, http://pnglng.com/media/pdfs/quarterly_reports/Q4-2011-ESR-ExecSummaryEng.pdf.

43 Export Finance and Insurance Corporation, EFIC Case Studies: PNG LNG Project, <http://www.efic.gov.au/casestudies/Pages/PNGLNGproject.aspx>.

44 Scott Ludlam, Foreign Affairs, Defence and Trade Legislation Committee Hearing, Estimates, Parliament, 24 February 2011, <http://scott-ludlam.greensmps.org.au/content/estimates/export-finance-insurance-corporation>.

45 Export-Import Bank of the United States, Ex-Im Bank Financing for Papua New Guinea LNG Project to Generate Significant Revenue for Island Nation, While Employing Workers at Dozens of American Companies, 14 December 2009, <http://www.exim.gov/pressrelease.cfm/8F2036C5-C2D5-A3DB-0E90CFB3EFBC0262/>.

46 Kane, op. cit.

47 Jubilee Australia, op. cit., 12-14.

I had it wrong I apologise - was, 'Is there a national interest statement and can it be published?' My response to you is that the national interest process consists of cabinet considering a national interest proposal. The documentation that goes into that is a cabinet submission.⁴⁸

Later, when Senator Ludlam requested to see the cabinet submission, he was refused. Senator Ludlam also requested to see the security assessment performed for ExxonMobil by the independent firm Control Risks Asia-Pacific, but the request was refused on the basis that the assessment had not even been shown to EFIC.⁴⁹ Under the EFIC Act 1991, the Minister's decision to invest via the National Interest Account is not open to Parliamentary scrutiny.⁵⁰

Although the securing of contracts for Australian businesses was probably the primary reason for EFIC support, it is also important to remember PNG is a former Australian colony and Australia's largest aid recipient (recall from Section 1.1 that Australia gives approximately ten times more than the second biggest aid donor to PNG). As a result, PNG holds a place of major importance in Australian foreign policy and policymakers may have thought that it was important to have, through EFIC involvement, not just an economic but also a political 'stake' in the most influential project to come to PNG in its history. And as discussed in Section 1.2, support for the Project was given despite the Australian and the United States' Governments' full awareness of the governance problems plaguing PNG.

Interestingly, whereas the Asian Development Bank (ADB) made the implementation of EITI a condition of project finance, the Export Credit Agencies which ultimately backed the PNG LNG did not. The resulting issue of irresponsibility on behalf of these public ECAs and their associated governments, including the Australian Government, was highlighted previously in Jubilee Australia's 2009 *Risky Business* report.⁵¹

THE PRIVATE BANKS

The remainder of the debt financing is provided by a consortium of 17 international banks, who together put up \$US1.95 billion for the Project—a combined involvement less than a quarter than that of the ECAs. The banks include Sumitomo Mitsui Banking Corporation, ANZ, Commonwealth Bank of Australia, National Australia Bank, Westpac, Bank of Tokyo-Mitsubishi, Mizuho, Sumitomo, Standard Chartered, BNP Paribas, Calyon, Credit Industrial et Commercial, Intesa Sanpaolo, UniCredit, Société Générale, Natixis and DnB Nord.⁵² Given that the private financing was secured

48 See Foreign Affairs, Defence and Trade Legislation Committee, Thursday 24 February 2011 <http://scott-ludlam.greensmps.org.au/content/estimates/export-finance-insurance-corporation>.

49 Ibid.

50 Commonwealth of Australia Consolidated Acts, Export Finance and Insurance Corporation 1991, Section 27, http://www.austlii.edu.au/au/legis/cth/consol_act/efaica1991402/s27.html.

51 Jubilee Australia, op. cit., Chapter 1.

52 See Banktrack, Liquefied Natural Gas (LNG) Project Papua New Guinea, <http://>

after that of the Export Credit Agencies, it is likely that the significant ECA support for the Project assisted in bringing the banks on board.



Photo credit: Antony Loewenstein.

2.3 THE PNG STATE

PNG's National Government has been an enthusiastic proponent of PNG LNG from the very earliest stages of the Project's development. We might indeed say that it has often been difficult to tell which entity was more determined to make the Project happen: the operator ExxonMobil, or the PNG Government. And it is not hard to see why this was the case. The Project is expected to increase government revenues dramatically at a time when some of the country's largest and ageing mines like Porgera and Ok Tedi move to reduced production and closure over the next decade.

The PNG Government's involvement in the deal needs to be examined from two angles: 1) its position as an equity partner in the Project; and, 2) the broader legal framework for the Project which it negotiated as the sovereign state of PNG.

THE STATE AS CO-VENTURER

The collective equity holdings of the PNG Government and landowners is 19.6 per cent. Such an involvement is made possible by PNG law, which grants the National Government the right to purchase a participating interest not exceeding 22.5% in petroleum projects.⁵³

In securing financing for its equity share in the Project, the PNG Government made an agreement in 2009 to issue an exchange bond facility worth \$AU1.68 billion to the Abu Dhabi-based International Petroleum

www.banktrack.org/show/dodgydeals/liquified_natural_gas_lng_project.

53 Independent State of Papua New Guinea, op. cit., Oil and Gas Act 1998, Section 165. The state's right to acquire 22.5% equity relates to each individual production field and the Government has historically already taken this 22.5% interest in Kutubu, Gobe and Moran. In contrast, in the new gas fields of Hides, Angore and Juha, the government, in taking only 16.6%, appears to be taking less than the full amount that it has the right to.

Investment Company (IPIC). The revenue projections mentioned above incorporate the Government's repayment of this liability. However the 2012 Budget has confirmed that the Government is facing a shortfall in financing its share in the Project, with additional borrowing of \$US258.0 million (K561 million) required.⁵⁴ It was decided under the new O'Neill Government that this shortfall, plus an additional K339 million for potential contingencies such as exchange rate movements, would be funded via the issuance of K900 million domestic debt securities.⁵⁵

In order to manage its long-standing involvement in the resource sector, the PNG government has set up various state-owned enterprises (SOEs). The three such public corporations involved in PNG LNG are: (1) the National Petroleum Corporation of PNG (NPCP), formerly called Kroton No. 2⁵⁶ (16.6 per cent); (2) Petromin Holdings Pty Ltd (0.2 per cent); and, (3) the Mineral Resource Development Corporation, or MRDC (2.8 per cent). NPCP, an SOE established by legislation in 2008, is a subsidiary of the Independent Public Business Corporation (IPBC).⁵⁷ On behalf of NPCP and through the debt financing mentioned above, the IPBC paid EHL to acquire the participating interest in the Project. For more on the centrality of the IPBC in the PNG LNG story, see chapter 4.

THE LEGAL FRAMEWORK

It will be recalled from Section 1.2 that PNG law vests ownership of all underground resources in PNG to the state. The state is nevertheless obliged to negotiate an agreement with the landowners of the affected territory before it can finalise any investment deal with resources companies, a process which is discussed with respect to PNG LNG in the next section. However, the Government also negotiates directly between itself and the companies a legal framework for such a venture. In the case of PNG LNG, this framework consists of a number of key public and private agreements.

On 22 May 2008, the PNG LNG Gas Agreement set out the broad legal framework for the Project. The contract outlines the agreed terms between the Companies and the PNG Government, including fiscal provisions (such as arrangements for exporting, importing and selling of the gas), the obligations of the Government and the scope of its participation, and the operational requirements of the Companies.⁵⁸ The agreement also records that the state will translate its obligations regarding the provision of exemptions and fixed rates of duties, excise, royalties, taxes and state participation, into binding legislation.

54 See PNG Government Department of Treasury, 2012 Budget: Expenditure and Financing, Vol.1, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/Volume1/chapters/vol1.chapter4.pdf, 61.

55 *Ibid.*, 61.

56 Kroton No.2 has been re-named National Petroleum Company PNG (NPCP). For the purpose of this report all references to NPCP refer to the formerly-named Kroton No.2.

57 There was disapproval expressed in some quarters about the decision to create a new SOE, since the government had the already established Petromin PNG Holdings Pty Ltd as the SOE responsible for managing national interests in oil and gas.

58 Independent State of Papua New Guinea, The PNG LNG Gas Agreement, 22 May 2008 http://www.banktrack.org/manage/ems_files/download/png_lng_gas_agreement/080522_png_lng_agreement_execution_version.pdf

The following year, on 2 April 2009, a Fiscal Stability Agreement between ExxonMobil and the Government was signed.⁵⁹ Fiscal stability agreements, also known as stabilisation clauses, are stipulations in private contracts between investors and host states that provide security against changes in state law during the life of a project. Though the document has not been publicly released, ExxonMobil confirmed in a response to Jubilee Australia's inquiry that the final signed Fiscal Stability Agreement appears in exactly the same terms as in the draft version, published as Exhibit P to the 2008 PNG LNG Gas Agreement. The agreement provides a guarantee by the PNG State of fiscal stability throughout the life of the Project, through the freezing of all taxes, duties, fees and fiscal imposts related to the Project, and indemnifying the Companies against any additional payments. Furthermore, the agreement establishes that the state also indemnifies the Companies against changes in applicable laws, regulations and other legal measures that 'adversely and materially affect the economic position of an LNG Project Company in respect of the LNG Project'.⁶⁰

Stabilisation clauses of this nature have been described in a paper by the UN and the IMF as 'a widely used risk management device in investment contracts'. While many of these indemnities might be common practice in agreements between resource companies and developing country governments, it is nonetheless important to stress that such conditions place the burden of risk for unforeseen problems upon the host country. One of the concerns this paper raises about stabilisation agreements is that they can indemnify companies from prosecution for violations against laws that are subsequently enacted to help protect the people who are impacted by projects.⁶¹

ExxonMobil negotiated other significant cost reductions with the PNG Government, including a number of extremely generous tax concessions. These involve tax deductions for political risk insurance, the hiring of ships or aircraft for the purposes of the Project, and a certain amount of spending on approved infrastructure projects.⁶² Although the rationale behind tax deductions for infrastructure spending may be based on the assumption that it holds a benefit for PNG citizens, the same cannot be said for deductions on the aircraft hire and the political risk insurance. The political risk deductions alone total \$US950 million. Jubilee Australia is of the opinion it is improper that the costs for this be borne by the people of PNG, through the resulting loss of corporate tax income.

Also having important consequences for the Project and peace in PNG is the contingent liability taken on by the PNG Government. The PNG Government has issued a completion guarantee of approximately \$US2.5 billion (K5.4 billion) for the state's share in the

59 ExxonMobil, PNG LNG Project Fiscal Stability Agreement Signed, 22 April 2009, http://pnglng.com/media/pdfs/media_releases/media_release_090422_fiscal_stability_agreement_signed.pdf.

60 Independent State of Papua New Guinea, *op. cit.*, The PNG LNG Gas Agreement, Exhibit P, Clauses 2.3 and 3.1.

61 See also United Nations Special Representative to the Secretary General on Business and Human Rights and the International Finance Corporation, *Stabilisation Clauses and Human Rights*, March 2008, 4-9, for a discussion of different approaches to stabilisation clauses.

62 See Independent State of Papua New Guinea, *op. cit.*, The PNG LNG Gas Agreement, Exhibits K and M for proposed amendments to the Income Tax Act.

Project debt, which will be in place until the Project reaches the construction phase.⁶³ The Government is subsequently responsible for major financial penalties if there are problems in the delivery of the gas to the buyers due to hold-ups in the construction phase.

PRESSURE OR WILLINGNESS?

It has since been alleged that the Government was pressured into the signing of these agreements by the Companies, who, it is implied, used the threat of meeting certain Project timelines to push for the swift resolution of the legal and practical aspects of the deal. Former Attorney General and Justice Minister Dr Allan Marat and his office claimed in 2010 that they had less than 24 hours to analyse the 200 page PNG LNG Gas Agreement and provide advice on whether the agreement was in the best interests of the country.⁶⁴ According to Marat:

This gas agreement was drawn up overseas. It was taken away from our government negotiating team and structured overseas. And, we are now forced to dance to the music of foreigners.⁶⁵

Following this, the then-Deputy Prime Minister Sam Abal said in 2011 that the signing of the PNG LNG Gas Agreement was rushed and that, due to pressures from the Companies, ‘the government had no choice but to conform to the will of the developer and entered into the PNG LNG agreement’.⁶⁶

In response to a letter from Jubilee Australia, ExxonMobil refuted these claims, arguing on 12 June 2012 that the speediness of negotiations could be explained by the PNG Government’s reliance upon many of the same fiscal terms previously agreed in relation to the ExxonMobil Queensland pipeline proposal, a plan eventually abandoned in 2006 (see ExxonMobil Response in Appendix 1).

2.4 THE LANDOWNERS

The other critical set of actors in the PNG LNG story are the Landowner groups associated with the Project. Project-affected land is divided into two parts: Project Impact Area (PIA) land refers principally to wellhead areas—land from which the gas is drawn. Project Development License (PDL) land refers to land being used for the gas pipeline and for the LNG plant in Caution Bay, an area known as PDL152. The Landowner groups and their compensation/entitlements are categorised to a section of land that falls into either of these two areas. Thus ‘PIA Landowners’, for example, refers to those officially-sanctioned landowners who are deemed to represent the land that falls into the section of the Project Impact Areas. For the rest of this Report, all of the PDL and PIA groups will henceforth be collectively referred to as the Landowners.

Landowners and sub-national governments at present have a 2.8 per cent share of the Project equity; in addition, they have the right to purchase a further 4.4

63 PNG Government Department of Treasury, op. cit., 2012 Budget: Overview and Revenue, 63.

64 “LNG law foreign says former AG,” The National, 18 May 2010, <http://www.thenational.com.pg/?q=node/9202>.

65 Ibid.

66 See Patrick Talu, “Exxon Made Us Do It: Sam Passes the Buck,” The National, 31 January 2011.

per cent of equity. On top of the equity, there is the potential to access some of the business opportunities flowing from the Project. A more detailed discussion of the role and function of revenue streams and of the business opportunities for Landowners is presented in chapter 5. For now, it is important to emphasise that the way in which the Government and the Companies manage the hopes and expectations of the landowners with respect to these matters, and how the Landowners themselves interpret and respond to events as they unfold, will be a decisive factor in the outcome of the entire Project.

Within the direct Project Impact Area in the Hela Province and PDL152, there are overall 117 census units (i.e. villages) supporting approximately 34,000 people. A list of the different ethnic groups is given in the Table 2 following.

| Regional Catchment Areas (Social Impact Assessment) | Ethnic Groups |
|-----------------------------------------------------|-----------------------------|
| Kikori | Ikobi, Rumu, Kibiri, Kerewo |
| Moran | Moran Huli, |
| Hides | Hides Huli, |
| Kutubu | Foe, Fasu |
| Gobe | Samberigi |
| Juha | Febi |
| PDL 152 | Koitabu, Motu |

Table 2: PNG LNG Ethnic Groups (Source: PNG LNG Social Impact Assessment).

THE HULI PEOPLE AND THE NEW HELA PROVINCE

Currently, the wellheads and the main Project infrastructure fall in the Hela Province of the Southern Highlands of Papua New Guinea. The most significant of the Landowner groups in this area are the Huli people, who inhabit the Hides, Komo and Moran catchments and make up almost 50 per cent of the Project Impact Area populations (if you exclude PDL 152). The Huli population of approximately 100,000 is socially divided into some 300 to 400 named patrilineal clan units, each of which is segmented into lower-order descent units of sub-clans and lineages. Satellite descent units of any clan may be dispersed across Huli territory, though each clan has a traditionally-recognised locus of ritual and resource interests. The Huli do not fit into the ‘one clan, one piece of land’ schema, as many trace their origins to neighbouring ethnic groups and have migrated within and from outside the Hela region.⁶⁷

While the Hela region is part of the Southern Highlands Province, the Project has spurred the people of the Hela region to form their own Province. The new Hela Province was officially constituted in May 2012, just prior to the national elections which were seen as an

67 For a detailed description of the people in the Hela region of the Southern Highlands, see Chapter 3 of James McLraith, *The Community Good: Examining the Influence of the PNG LNG Project in the Hela Region of Papua New Guinea* (Otago University in Partnership with Church ChildFund Papua New Guinea, the New Zealand National Centre for Peace and Conflict Studies, the PNG Church Partnership Programme and the Oxfam Highlands Programme 2012), 20-24.

important test for the new Province and for PNG LNG itself.

A few observations should be made about the place of violence in Huli culture. Historically the cause of fighting is said to be 'land, women and pigs'. More recently, conflict over compensation for resource extraction projects, as seen elsewhere in PNG, has increased. A moral or even a social distinction between fighting, compensation payments and talking is hard to discern: all are seen as equally socially acceptable methods of dispute resolution. Also, there has been a tendency in Huli culture to reactivate patrilineal descent for past grievances if the present moment calls for it.⁶⁸ Laurence Goldman explains that "for many Papua New Guinea societies fighting is both a recurrent and legitimate means of prosecuting claims or seeking restitution". He goes on to say that for the Huli, fighting and compensation are the:

[...] cultural scripts about how and why people exist as they do. Such public attestation of power and status—what they get out of fighting and compensating in the manner they do—has yet to be radically transformed by any social change movement. Huli fight and compensate as a ritual of deference to collective norms and societal values. Opting out is not an option unless one's name and membership status is of no value.⁶⁹

We will return to the implications of these observations in Chapter 5, when the risk of violence posed by the impact of PNG LNG in the Southern Highlands and the Hela Province is considered.



Poster displayed in Bougainville 2012.
Photo credit: Antony Loewenstein.

THE LANDOWNER NEGOTIATIONS

Another recurring issue related to the Project is the circumstances under which the negotiations with Landowners have taken place. As with negotiations between the Companies and the Government, the process was rushed, on top of which various procedures were not followed. In this case, it is the Government—not the Companies—who bear responsibility for any breaches of protocol. That said, one cannot rule out the possibility that the

68 These reflections are all drawn from Lawrence Goldman, "Hoo-Ha in Huli: Considerations on commotion and community in the Southern Highland" in *Conflict and Resource Development in the Southern Highlands of Papua New Guinea*, eds. Nicole Haley and Ron May, *State, Society and Governance in Melanesia Program Studies in State and Society in the Pacific*, No. 3 (Australian National University E Press, 2007), 73-75.

69 *Ibid.*, 75.

Government pushed through the agreement in an attempt to meet Company-assigned deadlines.

THE UMBRELLA BENEFIT SHARING AGREEMENT

On 23 May 2009, the PNG National Government, representatives of the Project area Landowners, and four provincial and ten local-level governments met in Kokopo to sign the Umbrella Benefit Sharing Agreement (UBSA).⁷⁰ Under the agreement, it was predicted that Landowners would receive more than K20 billion over 30 years.⁷¹

The process was beset by a number of problems, including:

- 1) The site of the conference: Under PNG Law, the Minister is supposed to convene a Development Forum 'at a place close to the proposed license area' to provide ease of access for the people affected.⁷² Instead, the Development Forum to negotiate the UBSA was conducted far away in Kokopo on the island of East New Britain.
- 2) The issue of whether the attendees were proper representatives of the Landowner constituencies. The forum initially started with 150 participants largely hand-picked by the Government and Companies to represent all the Landowners. But the number of participants is said by Kokopo locals to have reached about 2000 people by the end of the conference as hundreds descended on the town from the Southern Highlands and other Project areas, expecting to be part of the forum.⁷³
- 3) Procedural problems: The development forum was supposed to be witnessed by a number of independent observers to verify the probity and produce a public record of the proceedings. However, at least one of the key independent observers, Transparency International PNG, had its invitation to attend the forum revoked, raising doubts as to whether any truly independent observers were present.⁷⁴

LICENCE-BASED BENEFIT SHARING AGREEMENTS

The UBSA's main function was to assign Project-wide benefits between licence areas. Following this step, the UBSA called for agreements between Landowner groups/sub-national governments and the PNG Government for each individual licence area through individual Licence-based Benefit Sharing Agreements (LBBSAs). All LBBSAs had to be settled before the Final Investment Deadline on 8 December 2009 in

70 The agreement came on the heels of a Coordinated Development and Operating Agreement (CDOA), signed on the 13 May 2008, which established production contribution for each production and pipeline licence and formed the basis for equity distribution to landowner trustee companies.

71 Matthew Murphy, "PNG Landowners to receive \$9.5 billion," *The Age*, 25 May 2009, <http://www.theage.com.au/business/png-landowners-to-receive-95bn-20090525-bkuf.html#ixzz1Scu4AD3P>.

72 Independent State of Papua New Guinea, op. cit., Oil and Gas Act 1998, Section 48(1).

73 Confidential communication between Second Author and informant, 16 September 2011.

74 Transparency International PNG, "Transparency International PNG (TIPNG) invitation to be independent observers at BSA forum withdrawn", Media Release, 21 May 2009, http://archive.transparency.org/news_room/latest_news/press_releases_nc/2009/2009_05_22_png_independent_observers (See Appendix 2).

order for the Project to go ahead. But as outlined in *Risky Business*, in-fighting and disputes among members of the group meant that many Project-affected areas struggled to sign before the deadline.

Herein lies the great source of potential conflict over the Project's resource revenues. Groups within each Project-affected area quarrelled for an agreement that maximised their benefits, leading to conflict and an eventual gridlock among many groups.⁷⁵ Just days before the deadline was reached, the Government threatened to unilaterally impose its own terms on Project-affected areas that would not negotiate and sign. This threat was effective in bringing most of the struggling groups to agreement.⁷⁶

It is unknown how much ill-will has been left by these eleventh-hour agreements and whether the forced nature of the accords will come back to haunt the Government through inter-clan conflict.

LANDOWNER IDENTIFICATION

The University of Otago Report 'The Community Good' published in May 2012, deals with the question of landowner identification at some length. The research found discrepancies between the types, extent and timing of landowner consultation and mapping required under the Oil and Gas Act 1998, and that which has actually occurred. Despite the legislation requiring both full-scale social mapping and landowner identification to be carried out 'upon discovery and confirmation of the Project', the PNG LNG Gas Agreement only stipulated the undertaking of a 'preliminary distribution map'. Prior to the Development Forums, the key moment at which the Landowners came to endorse the Project, only the social mapping and not the landowner identification had been carried out.⁷⁷ In fact, at the time of the Report's publication (May 2012), a full two years after the Final Investment Deadline, landowner mapping was still being completed.⁷⁸

There is no question that landowner identification in this region is costly, complicated and time-consuming. Nevertheless, the inability of the Project proponents, especially the PNG Government, to finalise landowner identification has magnified the confusion as to who the landowners are, a situation that could have serious implications (discussed in Chapter 5). It is also clear that proceeding with the Project before the landowner identification process was complete, indicates another inconsistency between the Project's execution and PNG law.

EARLY WARNINGS

Anthropologist Laurence Goldman, hired by ExxonMobil to write the Social Impact Analysis, wrote in early 2009 that the benefit sharing agreements

⁷⁵ "FID Set for Tomorrow," The National, 7 December 2009, <http://the.national.com.pg/?q=node/3695>.

⁷⁶ For the media reporting on the flurry of activity surrounding the benefit-sharing agreements, see the series of reports from The National: Barnabas Pondros, "Landowner scramble to sign after FID," The National, 9 December 2009, <http://www.thenational.com.pg/q=node3695>; Barnabas Pondros, "Deal Hits Snag," The National, 7 December 2009, <http://www.thenational.com.pg/q=node3696>.

⁷⁷ See McIlraith, James. *The Community Good: Examining the Influence of the PNG LNG Project in the Hela Region of Papua New Guinea*, May 2012, 32.

⁷⁸ *Ibid.*, 33.

process should be completed according to the following principles:

- Transparency: community consent to and knowledge of all constituent benefits sharing agreement processes.
- Equity: no Project stakeholder constituency, ethnic, gender or generational, is disadvantaged or disempowered by the agreement process.
- Manageable Representation: the community should assemble together or in manageable groups to facilitate negotiation.
- Mandated Representation: the assembled community must be publicly seen to reflect the mandate of the affected and impacted Project Landowners.⁷⁹

The UBSAs and LBSAs were not signed in line with Goldman's recommendations, an outcome which he had himself predicted in the report, when he noted:

[...] while the Benefits Sharing Agreement is the cornerstone for social development in the Project area over the next 30 years, adherence to these principles is likely to be encumbered by the inter-ethnic baggage of both pre-and post-colonial relations in the region.⁸⁰

While Esso Highlands Ltd (EHL) and the other Project venturers might justly say that the deficiencies in the benefit sharing agreements should be the responsibility of the Government, not the Companies, it is equally possible to argue that the Companies did not give due consideration to Goldman's warning.

SUMMARY FINDINGS

- PNG LNG is the largest project in PNG history and one of the largest energy finance deals on record. PNG LNG, which includes an arrangement that involves:
 - ExxonMobil, the world's third-richest corporation, in co-operation with a number of smaller corporate partners, most notably Australia's Oil Search;
 - six National Governments through the involvement of their Export Credit Agencies, who are providing the majority of the financing in order to secure contracts either for their domestic companies or for gas sales. (We have argued in this Chapter that without the support of ECAs, the deal would have been far more difficult, or perhaps impossible, to complete);
 - the enthusiastic support of the PNG Government, which is both a broker for - and a participant in - the deal, through the equity ownership of some of its state-owned corporations. (The general enthusiasm of the Government is most evident in its generous tax regime for the oil and gas sectors);
 - the Landowners of several PNG Provinces (Most of the Project's gas wellheads in the Southern Highlands are situated in the newly-created Hela

⁷⁹ Chapter 23 of the Environmental Impact Statement, pp. 2-3. [...]

⁸⁰ *Ibid.*, pp. 2-3.

Province - formerly part of the Southern Highlands Province, which is dominated by the Huli ethnic group).

- A number of concerns remain in respect to the way negotiations surrounding the legal framework for the Project were handled by the Government and the Companies. For example:
 - senior members of the Government claim they were forced into an agreement. Suspicions remain surrounding this pressure and the generous tax concessions made by Government to the Companies;
 - in line with predictions by an independent consultant to the Companies, the necessary involvement of the Landowners was chaotically secured, as hundreds swarmed the Development Forum in far away Kokopo after it had begun;
 - consent among Landowners was only achieved through undue pressure from the Government.
- Responsibility for oversights and failures in due diligence could be said to rest as much - or perhaps even more - with the PNG Government than with the Companies. Nonetheless, what is of greater concern is the repeated pattern wherein both parties deny accountability, often blaming the other while doing so. The biggest losers in this 'to-and-fro' are the ordinary citizens of PNG.

3 THE ECONOMIC CHALLENGES OF RESOURCE WEALTH

While, theoretically, a country's wealth in natural resources should provide a large boost to its economy, in fact the inverse has proved to be true; resource-abundant economies tend to grow at a slower rate than those that are resource-scarce. This phenomenon has become known as the 'resource curse'. Throughout its history of mining projects, many have claimed that PNG could defy this trend by transforming its mineral wealth into growth and development. But such an outcome has not yet occurred. Why should the case of PNG LNG be any different?

This chapter will consider the opportunities and challenges that lie ahead for the PNG economy as a result of PNG LNG, through both its direct economic impacts and the indirect, economy-wide effects. In particular, it will subject to closer scrutiny the overwhelmingly positive projections made in the independent economic assessment commissioned by the Companies, the PNG LNG Economic Impact Study of February 2008, hereafter referred to as 'the EIS'.

Given the magnitude of the LNG Project, there is no doubt that the Project will transform PNG's national economy. Yet what form this transformation will take, and who stands to benefit, are key questions that need to be addressed.

3.1 THE PROMISES

The EIS of 2008, completed by the Australian-based economic consultant firm ACIL Tasman, is the primary study used by the Companies to support their claims of economic potential delivered via the Project. According to the EIS, potential economic benefits to PNG as a result of the Project include:

- total capital investment of more than \$US10 billion;
- recurring operating expenditure of more than \$US195 million per year;
- doubling of Gross Domestic Product (GDP);
- four-fold increase in oil and gas exports;
- direct cash flows to Government and Landowners of more than \$US31 billion over 30 years;
- direct employment (national and expatriate) of more than 7,500 during construction and 850 during production.

The Australian Government's optimistic tone about the transformative effects of the Project, including the potential for poverty reduction, was also no doubt spurred by the promises of the EIS. In 2010, then-Australian Minister for Foreign Affairs and Trade, the Hon Stephen Smith MP, said:

[...] the LNG Project is vital to Papua New Guinea's economic well-being, with the potential to put Papua New Guinea on a sustainable economic growth path.²

ExxonMobil itself also didn't hesitate to fan this flame, urging the Government to support the Project in a submission to Australia's 2008 Inquiry into the Main Economic and Security Challenges Facing Papua New Guinea and the Island States of the Southwest Pacific:

ExxonMobil welcomes the Australian Government's interest in economic growth [in PNG] as a means of promoting community development....³

It is also reasonable to assume that the Australian Trade Minister used the official economic impact study to weigh up the risks and opportunities related to PNG LNG. ⁴ The result was a decision to invest up to \$AU500 million of Australian public money to back the Project.

3.2 UNPACKING THE OFFICIAL PROJECTIONS

In measuring the net change to the level of economic activity in PNG, two categories of economic impact must be considered: firstly, the direct economic impact, which is sometimes referred to as the 'first round' of spending; this includes transactions and investment decisions occurring as a consequence of the Project, that directly impact the flow of income, spending and jobs in the economy; secondly, there are also broader, indirect, induced and dynamic economic effects that follow, sometimes referred to as 'multiplier effects'.

This section will consider the economic impact of the PNG LNG by discussing, in turn, each of the indicators listed below.

Direct economic impacts

- Capital investment
- Employment and training
- Direct cash flows to government and landowners
- Petroleum exploration and production activity

² Stephen Smith, Australian Minister for Foreign Affairs and Trade, Australia-PNG LNG Ministerial Meeting, 1 July 2010, <http://www.foreignminister.gov.au/releases/2010/fa-s100701.html>.

³ Peter M. Graham, Inquiry into the Main Economic and Security Challenges Facing Papua New Guinea and the Island States of the Southwest Pacific (Esso Highlands Limited, 28 September 2008), http://www.aph.gov.au/binaries/senate/committee/fadt_ctte/swpacific/submissions/sub34.pdf, 4.

⁴ More specific information about the Australian Government assessment of the Project and basis for investment is not available in the public domain. Furthermore, under the current legislation, EFIC Act 1991, the Minister's decision to invest via the National Interest Account is not even open to Parliamentary scrutiny. Commonwealth of Australia Consolidated Acts, Export Finance and Insurance Corporation 1991, Section 27, http://www.austlii.edu.au/au/legis/cth/consol_act/efaica1991402/s27.html.

¹ See ACIL Tasman, op. cit.

Indirect economic impacts

- Gross Domestic Product (GDP) and Gross National Income (GNI)
- Oil and gas exports
- Exchange rate
- Trade balance
- Public debt
- Inflation
- Sectoral impacts and Dutch Disease
- Labour market

DIRECT ECONOMIC IMPACTS

Capital investment

Highlighted in the EIS and reiterated in public discussions by the Project's supporters is the estimated \$US10 billion in capital investment to be spent in real terms over the 30-year life of the Project, with equipment accounting for 55 per cent, and the balance attributed to labour.⁵ The bulk of this money, an estimated \$US8.3 billion, will be outlaid during the initial four year construction period (2010 to 2014).

Natural resource sector projects are generally capital-intensive and asset-specific. Once sited, the assets are almost immobile, and such investments in facilities and equipment tend to be unique to a particular mine and region.⁶ Thus, it has been well-established that such developments bring about few positive externalities to forward and backward industries.⁷

What is most relevant about the Project's capital investment for the PNG economy, therefore, is the extent to which it draws on goods and services supplied by PNG households and firms. Of particular importance is investment for which the profits and wages will remain in PNG, as opposed to imported materials and imported labour, for which most of the financial benefit will flow offshore.⁸ PNG's Oil and Gas Act places a number of requirements on the Project with respect to national content. For example, it states that licensees are to:

Use and purchase goods and services supplied, produced or manufactured in Papua New Guinea whenever the same can be obtained at equivalent terms, including prices, conditions and delivery or performance dates and are in all respects of a quality comparable with those available from outside Papua New Guinea.⁹

In adhering to the Act and as part of the Companies National Content Plan of 2009,¹⁰ EHL established

5 ACIL Tasman, op. cit., 6.

6 S. Masten and K. Crocker, "Efficient Adaptation in Long-Term Contracts: Take-or-Pay Provisions for Natural Gas," *American Economic Review*, 75 (December 1985), 1083-93.

7 Jeffrey Sachs, "Sources of Slow Growth in African Economies," *Journal of African Economies*, 6 (October 1997), 353-76.

8 Peter B. Dixon, Gae Kauzi and Maureen T. Rimmer, "Effects on the PNG Economy of a Major LNG Project," *Economic Papers: A journal of applied economics and policy* 29, no. 2 (June 2010), Centre of Policy Studies Monash University, 145.

9 Independent State of Papua New Guinea, op. cit., Oil and Gas Act 1998.

10 Esso Highlands, Papua New Guinea LNG Project: National Content Plan (July 2009), http://pnglng.com/media/pdfs/national_content/National%20Content%20

an Enterprise Centre in Port Moresby to help build capacity and increase the competitiveness of domestic companies bidding for work with the Project.¹¹

The EIS points to capital investment as a primary economic opportunity for PNG. Yet despite these significant estimates of expenditure, particularly during the set-up phase, according to the EIS, less than 7 per cent of the \$US10 billion in capital investment over the life of the Project is expected to be sourced locally. The \$US5.5 billion of capital investment allocated to material inputs over the life of the Project (construction and operation phases) would consist entirely of imported products.¹² Of the remaining \$US4.5 billion to be spent on labour, 90 per cent would be invested in imported foreign labour skills during the construction phase, with this percentage expected to drop to 80 per cent after commissioning.¹³

Employment and Training

Direct employment and training opportunities created by the Project have been cited as another key economic opportunity for the PNG economy. Yet despite this emphasis placed on it in popular discussions, employment generation will not be a major contribution of the PNG LNG Project for three key reasons.

Firstly, a capital-intensive Project such as PNG LNG, despite a significant contribution to GDP, absorbs only a small percentage of total employment. The net benefit of employment opportunities for the PNG economy is further reduced when local content is considered. The EIS stated that the aggregate workforce required during the initial period from 2008 to 2013 was expected to peak in 2010 with 7,500 employees, of which 6,000 were to be filled by expatriates.¹⁴ Although the positions for domestic employees ended up higher than this¹⁵, the number of



Komo station road being fixed.
Photo credit: James McIlraith/University of Otago.

Rev%200.pdf, 24.

11 PNG LNG, PNG LNG Project Enterprise Centre (2010), http://pnglng.com/media/pdfs/media_releases/media_release_100125_pnglng_enterprise_centre_fact_sheet.pdf.

12 ACIL Tasman, op. cit., 9.

13 Ibid., 9.

14 Ibid., 11.

15 In a positive development, EHL reported last year that earlier projections for employment were significantly understated. Two years into the Project, at the peak of the construction phase in March 2012, EHL reported that 8,500 nationals were employed by the Project. This substantial increase has been attributed to the success of Lancos in securing construction phase business opportunities.

people directly employed is very small, as compared with total employment.

Secondly, these numbers are temporary. Once the Project moves into production phase around 2014, total employment on the Project is expected to drop to an average of 800, including full time positions and contract personnel.¹⁶ While it is anticipated the majority of these positions will be filled by locals,¹⁷ questions remain about the fate of the workers whose services will no longer be required, especially in the Project areas.

Thirdly, the EIS fails to address the fact that the relatively highly-paid construction-boom salaries might negatively impact on the quality of public services by drawing important human resources away from the public sector. For example, it has been reported that a pay rise for PNG's teachers was not enough to prevent many teachers leaving their jobs to take up employment with the Project.¹⁸ The coffee industry is also reporting a loss in its skilled labour force as people move to take up construction contracts for the LNG Project.¹⁹

Direct Cash flows to government and landowners

The opportunity created by PNG LNG revenues is clearly the main contribution of the Project to the country's economy and its citizenry. The National Government, Provincial Governments and Landowners stand to receive, or in some cases have already received, substantial injections of income as a result of the Project. The ACIL Tasman EIS estimated the total direct cash flow to the PNG Government and Landowners from the LNG Project at more than \$US30 billion (K114 billion) over a 30-year life of Project. This includes taxation revenue, proceeds from the development levy and royalties, dividends from the State's equity share in the Project, and cash payments to Landowners. (A full break-down of the Government's income is given in chapter 4 and income at the local level discussed in depth in chapter 5).

The EIS suggests that the large sums of income from the Project will 'spread throughout the economy' and thereby provide long-term improvements in the quality of life for the people of PNG through government investment in infrastructure and expenditure on social services.²⁰ However, as this chapter and the next will show, significant questions must be asked about the likelihood of these revenues being spent well. Jubilee Australia believes that the anticipated benefits of the Project are overly optimistic, given the National and Provincial Governments' poor track record as

16 ACIL Tasman, op. cit., 12. It is expected the proportion of local construction workforce will increase to 35-40 % during the later construction periods (2017-18, 2020, 2022, 2027).

17 See Ancilla Wrakuale, "LNG local labour faces cuts after construction phase," The National, 15 March 2012, <http://www.thenational.com.pg/?q=node/30256>. Also see ACIL Tasman, op. cit., 12. It is expected the proportion of local construction workforce will increase to 35-40 % during the later construction periods (2017-18, 2020, 2022, 2027).

18 See Firmin Nanol, "Pay rise to keep PNG teachers in class," Radio News Australia, 13 June 2011, <http://www.radioaustralianews.net.au/stories/201106/3242166.htm>.

19 Malum Nalu, Coffee industry to be affected by LNG Project (3 April 2011), <http://malumnalu.blogspot.com.au/2011/04/coffee-industry-to-be-affected-by-lng.html>.

20 ACIL Tasman Executive Summary, first paragraph, states: "The benefits from the Project would spread throughout the economy as the government applies the earnings from its substantial share of the Project revenues to social and economic programs." ACIL Tasman, op. cit., v.

principal vehicles for delivering benefits to citizenry. Even the EIS includes an acknowledgment that in PNG there is little precedent for such injections of Project revenue translating into positive benefit for the wider community. According to the report:

Despite the unique opportunity for governments at all levels to channel their share of the proceeds into improving infrastructure and services for the local communities, there is a risk that much of these resources will not reach the target beneficiaries. For example, Simpson and others (1998a) observed that in the Southern Highlands, there was little evidence of direct investment by the Provincial Governments in infrastructure and services.²¹

Increased petroleum exploration and production activity

The ACIL Tasman EIS also highlights as significant the potential for the petroleum sector to make higher levels of economic contribution to the PNG economy over the long-term. PNG LNG could provide a 'powerful demonstration effect of a successful large-scale gas industry development' in addition to the incentive for current international companies to stay actively involved in the country, plus provide a boost to the relevant skills, service capabilities and related infrastructure.²²

However—and as discussed below under sectoral impacts—the size of the Project means a significant reconfiguration of other sectors in the PNG economy. Thus any meaningful discussion of the potential benefits of the Project must consider its distortional effect on the rest of the economy, in particular the potential to undermine prospects for other important sectors like agriculture, which sustains the livelihoods of more than 85 per cent of the rural population, and fisheries, which the most recent Budget cites as sustaining the livelihoods of a quarter of the country's population.²³

In summary, the direct economic benefits offered by the PNG LNG are modest at best. Capital investment and employment are location- and Project-specific; less than 7 per cent of the \$US10 billion spent will be sourced locally; the construction boom employment opportunities will be temporary and provide little net benefit for human capital development. The direct income received over the life of the Project will be very large, yet will not necessarily contribute to PNG's economic growth; and, the sharp increase in the petroleum sector will have distortional effects on the rest of the economy, the net outcome of which it is difficult to predict.

ECONOMY-WIDE IMPACTS

What follows is a consideration of the LNG Project's relationship to key macroeconomic indicators in the PNG economy. The EIS's projected macroeconomic benefits most frequently cited by the Projects'

21 ACIL Tasman, op. cit., 26.

22 ACIL Tasman, op. cit., 14.

23 See PNG Government Department of Treasury, 2012 Budget: Sectoral Policies, Vol.1, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/Volume1/chapters/vol1.chapter10.pdf, 130-131.

supporters include: doubling of Gross Domestic Product (GDP); fourfold increase in oil and gas exports; and aggregate employment up 42 to 45 per cent.²⁴

Alongside the official Economic Impact Study by ACIL Tasman, analysis in this Section draws principally on information from two additional sources: the June 2010 Monash Study, 'Effects on the PNG Economy of a Major LNG Project' (hereafter referred to in this report as the 'Monash Study'),²⁵ and the 2012 National Budget of PNG, to the Parliament by the Minister for Treasury and Finance in December 2011.²⁶

Gross Domestic Product (GDP)

Under the Study Case assumptions of the EIS's economic modelling, the PNG LNG will cause the country's GDP to more than double,²⁷ (a net effect of a 97 per cent increase in real GDP in the short run, and in the long run, real output to increase by 99 per cent), as a result of growth in household consumption, government consumption, investment and net exports.

This forecast has been heavily relied upon in popular discussion about the Project, to cast overwhelmingly positive predictions about the macroeconomic impacts of PNG LNG. Yet the strong emphasis placed on doubling of GDP is problematic for two reasons.

First, the model in the EIS used to generate this forecast is problematic, by the authors' own admission. Adopting a static model, the authors simulated the effect on the economy of a 440 per cent per annum increase in oil and gas exports for a period of 5 to 10 years, as compared with a baseline representing the PNG economy in the absence of this Project-induced 'shock'.²⁸ By its own admission this static model is based on the unrealistic assumption that the economic shock resulting from the Project does not cause any change in the underlying structure of the economy or its sectoral make up. The authors note '[...] in the case of the PNG LNG, the scale of the Project compared to the size of the economy is such that this assumption is not realistic'.²⁹ Remarkably, the study goes on to note:

Therefore, it is important not to interpret the modeled outcomes as forecasts or accurate estimates of the size of the economic impacts. What is more meaningful about the analysis is that it helps to identify the industry sectors that stand to benefit from the Project, and those that are potentially disadvantaged, thereby allowing policy

makers to focus on how best to manage these impacts.³⁰

Jubilee Australia believes that the study fails to adhere to its own caution, considering that the projected doubling of GDP is cited in its influential Executive Summary without proper qualification, alongside statements that the Project will 'transform the economy of Papua New Guinea'.³¹ In effect, the outcomes identified by the ACIL Tasman study raise false expectations that are ripe for misuse.

Second, a number of studies published since the 2008 report, including the Monash Study, make the point that GDP is not the most relevant indicator of the potential welfare generated by the Project for the PNG economy. Instead, the studies concur that estimating the effects of the PNG LNG Project on Gross National Income (GNI) is more important, given that it represents the net benefit retained in PNG, once import costs, debts and remittances are deducted.³² The Monash Study estimated that the effect on GNI would be small but significant, approximately contributing a 5 to 10 per cent increase from the baseline over the life of the Project.³³

Oil and Gas Exports

The EIS predicts a significant expansion of oil and gas sector exports for PNG, with the 'shock' of an expected 440 per cent increase used to simulate the corollary effects on other aspects of the PNG economy. However it is important to qualify this projection in at least two ways: first, as acknowledged in the Monash Study, exports generated from the PNG LNG Project are owned mostly by foreigners, meaning that the revenue generated from the boost should not be interpreted as income for the PNG government.³⁴ For the most part, profit from the burgeoning oil and gas industry will be remitted offshore. Second, as discussed below in more detail, the magnitude of significant expansion of the oil and gas sector will severely distort the national economy, and lead to the contraction of other important export industries, as discussed below.

Exchange Rate

Another significant corollary effect of the huge expansion of the oil and gas sector in PNG and investment in foreign inputs related to PNG LNG construction is strong upward pressure on the exchange rate. The ACIL Tasman modelling shows an appreciation of the nominal and real exchange rate by 9 per cent against the US dollar in the short run and

24 ACIL Tasman, op. cit., vi.

25 Authors of the Paper are Peter Dixon and Gae Kauzi of Monash University's Centre of Policy Studies in Victoria, and Maureen Rimmer of the Bank of PNG, Port Moresby. The study was carried out with financial support from the Bank of PNG, although the views expressed are those of the authors and should not be attributed to the Bank. See Dixon, Kauzi and Rimmer, op. cit., 145. The Monash study takes a different approach to the ACIL-Tasman report in modelling of economy-wide effects of the LNG Project. Instead of a comparative-static model, the authors use a dynamic model to simulate the Project's effect on consumption, sectoral outputs, wage levels, trade and real exchange rates each year, from 2009 to 2050. The purpose of the Monash study's modelling is to understand the various outcomes of three different scenarios of macroeconomic management of the Project. In the author's opinion this makes the Monash study of economy-wide impacts more complete than the ACIL Tasman economic impact assessment.

26 See PNG Government Department of Treasury, 2012 Budget, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/.

27 ACIL Tasman, op. cit., vi.

28 The EIS uses a comparative-static computer-generated equilibrium model. ACIL Tasman, PNG LNG Economic Impact Study, pp.22 and 30.

29 ACIL Tasman, op. cit., 30.

30 Ibid., 30.

31 Ibid., vi, states: "The PNG LNG Project would provide a major boost to Gross Domestic Product (GDP) and exports. Under the Study Case Assumptions, GDP would more than double, rising in real terms from K8.65 billion in 2006 to an average K18.2 billion per year."

32 (1) The Monash Study (Dixon, Kauzi and Rimmer, op. cit., 155) says: ... in popular discussions, emphasis is often placed on GDP effects....As we have emphasised, the increase in GDP is not relevant. Attention should be concentrated on the effects on GNP and the consequent potential for increases in public and private consumption." And (2) INA study (See Paul Barker, PNG's Economy 2010 - Past, Present and Future Prospects), Institute of National Affairs (2010), http://www.inapng.com/pdf_files/Mining%20and%20Petroleum%20conf%202010.pdf,2.

33 The Dixon, Kauzi and Rimmer study finds that PNG LNG will raise GNP from its baseline by around 5-6% in the coming years, peaking at 10% in 2014, declining slowly to around 7% in 2030, and then more steeply after that to around 4% in 2042 (See Dixon, Kauzi and Rimmer, op. cit., 144 [Table 1 - Column 5]).

34 ACIL Tasman, op. cit., 145.

by 11 per cent in the long run (5 to 10 years).³⁵ However, the 2012 National Government Budget reports that over the 12 months preceding October 2011, the Kina in fact appreciated by 19 per cent against the US dollar. It also appreciated against PNG's other key trading currencies including the AU dollar (15.4 per cent), the Euro (20.5 per cent), Malaysian Ringgit (20.4 per cent), UK Pound (19.8 per cent), Chinese Yuan (13.7 per cent), NZ dollar (13.2 per cent) and the Japanese Yen (11.4 per cent).³⁶

Real appreciation of the Kina against the currencies of PNG's trading partners affects its international competitiveness, reducing the rate of growth of exports due to a contraction in production in some sectors, while increasing the rate of growth of imports and putting more stress on PNG's medium to long-term current account balance.

Trade Balance

After taking into account the declining output in other export sectors as a result of the LNG Project's reconfiguration of the PNG economy, the EIS shows real aggregate exports increasing by 106 per cent in the short run, and 107 per cent in the long run.³⁷ While the study shows real aggregate imports also increasing as a result of the Project, it indicates this increase will occur at a slower rate (58 per cent increase in the short run, 48 per cent in the long run), thereby maintaining a positive trade balance for PNG throughout the entire Project period.³⁸

However the ACIL Tasman study seems to have underplayed the significant pressure on the trade balance caused by the construction phase-induced import boost. According to the 2012 National Budget, after a trade surplus of 3.5 per cent of GDP was recorded for the first half of 2011, it was in fact expected that 2011 would record a net trade deficit worth 21 per cent of GDP, fuelled by high spending on imported goods and services related to the PNG LNG construction, as well as rising incomes amongst some groups of the population, inducing higher import consumption spending. Overall, the latest PNG National Budget estimates a large current account deficit of 33.6 per cent of GDP in 2012.³⁹ While this may not seem a problem in the context of the revenue windfall to come, the deeper the deficit created in PNG's current account, the more foreign currency earnings from the Project will be required simply to plug the hole before the revenue can provide net national income for current and future growth.

In contrast to the official EIS, the authors of the Monash Study argue that the Project's exports and imports are not relevant for assessing the impact on

the PNG economy.⁴⁰ Instead, they model the movement of real aggregate exports and imports over the Project period, to 2050, net of those generated directly by the PNG LNG. In all three scenarios simulated by their model, the Project shows a drop in non-LNG exports and a rise in non-LNG imports for the entire period to 2050. The study states:

The Project provides PNG with extra foreign currency income, allowing it to increase its consumption by importing more and exporting less.⁴¹

Though the 2012 Budget projects that the deficit will begin to reduce as the construction phase of the Project winds down and LNG exports begin, PNG faces challenges to its Balance Of Payments in the immediate years ahead, which will only be mitigated by prudent government management. The current uncertainty in the global economy means that it is possible to foresee a fallback in commodity prices, particularly as they are currently trading well above long-term averages. Additionally, the appreciating Kina will translate into lower export revenues for the government. Both prospects present risk to terms of trade and Government revenue in PNG.⁴²

Public debt

Despite serious debt problems from the late 1990s, over the 5 years leading to 2010 PNG's debt to GDP ratio fell by nearly 14 points, to 26 per cent. The pattern is expected to continue, with the ratio at the end of 2012 projected to fall to 23 per cent.⁴³ This positive trend has been offset, nevertheless, by an increase in off-balance sheet foreign currency liabilities (i.e. borrowing by State-owned agencies which are not included in the budget process or general Government debt), predominately related to PNG LNG. First, the Government issued a completion guarantee for the state's share of the PNG LNG Project debt of around \$US2.5 billion (K5.4 billion), which will be in place until the Project reaches the construction phase; and second, there is the state liability accumulated through the IPBC's borrowing of \$AU1.7 billion (K3.8 billion) to fund 18.2 per cent of the State's share of the LNG Project.⁴⁴ Overall, PNG Government's external debt plus the PNG LNG related off-balance sheet liabilities total 64 per cent of GDP. The latter, in particular, involves significant financial risk for the PNG Government, and means that the state's finances are heavily exposed to the success of the PNG LNG Project.⁴⁵ The Government's management of the level of foreign currency risk is therefore of central importance.⁴⁶

35 Ibid., 31. In addition, The Monash Study analysis indicates a PNG LNG-induced exchange rate appreciation for almost all years until 2050. See Dixon, Kauzi and Rimmer, op. cit., 151.

36 PNG Government Department of Treasury, 2012 Budget: Economic Outlook, Vol.1, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/Volume1/chapters/vol1.chapter2.pdf, 15.

37 ACIL Tasman, op. cit., 30.

38 A country's trade balance (net exports) indicates the relationship between the monetary value of imports and exports. It is represented as a calculation of net exports (exports minus imports), so that a trade surplus indicates a greater value of exports sold than imports purchased over a given period, while a trade deficit [...] the reverse.

39 PNG Government Department of Treasury, op. cit., 2012 Budget: Economic Outlook, 31.

40 Dixon, Kauzi and Rimmer, op. cit., 149-150.

41 Ibid., 149.

42 PNG Government Department of Treasury, op. cit., 2012 Budget: Economic Outlook, 32-33.

43 See PNG Government Department of Treasury, op. cit., 2012 Budget: Expenditure and Financing, 62.

44 Ibid., 63. Furthermore, IPBC requires an additional \$US258 million (K561 million) in order to fund its share of the Project cash calls. The Government has decided to fund this short-fall, plus an additional K339 million as a contingency for cost overruns, via the issuance of up to K900 million of domestic debt securities. PNG Government Department of Treasury, op. cit., 2012 Budget: Medium Term Fiscal Strategy, 150.

45 Ibid., 149.

46 Ibid., 150.

Inflation

The impact of the PNG LNG Project on prices and inflation is not directly addressed in the EIS,⁴⁷ despite the seriousness of the potential adverse effects on the cost of living for PNG citizens and higher costs of inputs for local businesses.

The 2012 National Budget reports that PNG LNG-induced inflationary pressure is already significant, with the Consumer Price Index (CPI) recording 9.6 per cent and 8.4 per cent in the June and September 2011 quarters respectively.⁴⁸ The estimate for 2012 is expected to show some relief, dropping to 7.6 per cent. However the PNG Treasury and Central Bank have implicitly acknowledged the obsolescence of the composition of the current CPI, and there is a widely-held belief that the inflation rate has been much higher than these official figures indicate.⁴⁹

Other worrying indicators include strong pressure on wages for skilled labour and increased rental prices for offices and accommodation, especially around Port Moresby.⁵⁰ With much of the economy already operating at capacity, this pressure on scarce resources is expected to intensify in the near future, as the economy absorbs the substantial impact of the Project, resulting in continuing high levels of inflation.⁵¹

Sectoral Impacts and Dutch Disease

There is little doubt that PNG LNG will cause adjustment in other sectors of the PNG economy. The key questions are what will be the nature and magnitude of this adjustment, and how will this effect the broader population. The different approach taken by the Monash Study provides helpful insights and comparisons with the ACIL Tasman EIS.

The onset of Dutch Disease caused by the large inflow of resource revenues poses one of the greatest threats to extractive-industry dependent economies. In the case of PNG LNG, the Project will cause contraction in the country's key export industries of agriculture and mining. This will occur because the currency

appreciation (and inflation) induced by the large inflow of gas revenues will reduce the competitiveness of PNG-produced exports, while increasing the competitiveness of foreign imports. Both factors cause contraction in other key non-extractive sectors. Both the EIS and the Monash Study show that export agriculture (coffee, cocoa, palm oil, copra and forestry) will be hard hit. The EIS estimates the value of the smallholder agriculture sector (especially smallholder palm oil) declining as much as 94 per cent,⁵² and the Monash Study predicts reduced output over the entire simulation period (2009 to 2050).⁵³

How will PNG LNG affect the economy's important export mining sector? While the ACIL Tasman study sees a relatively minor decline in gold and other mining activities,⁵⁴ the Monash Study modelling shows a negative effect which is even sharper than agriculture. The authors list three reasons for the decline: 1) export shares for mining are higher than those for agriculture; 2) the output of export agriculture is less elastic than that of mining (meaning it will not respond as quickly to price changes); and, 3) the much higher reliance on unskilled labour in agriculture means it is favoured by the LNG-induced changes in wages for skilled and unskilled workers.⁵⁵

Domestically-oriented industries (those with low export shares and little import competition) generally benefit from the Project.⁵⁶ In particular, expansion is likely to occur in domestically-oriented agriculture such as poultry or fruit and vegetables, as well as non-export related services such as health, education and public administration. Construction will also benefit, with greater demand for private housing and public infrastructure, especially within the construction phase of the Project.⁵⁷

While the ACIL Tasman EIS shows the manufacturing and transport sectors expanding significantly as a result of the Project in both the short run and the long run,⁵⁸ the Monash Study paints a different picture. The authors predict that while these sectors gain in the short-run due to provision of inputs to the construction phase, negative output deviations will follow during the entirety of the production phase. The authors argue that negative effects on transport will be associated with overall contraction of traditional exports, which are heavy users of internal transport services (taking flows from points of production to ports of exit), while manufacturing will face considerable competition from imports, and will be harmed by LNG-induced appreciation of the real exchange rate.⁵⁹

The most recent economic indicators from PNG, released just before publication of this report, are very telling. The PNG LNG Project is creating large ripple effects in the rest of the economy. Dutch disease is spreading in PNG, with extremely damaging effects on the broader economy. The Manufacturers Council



Photo credit: Antony Loewenstein.

47 In the AT static model used, CPI is set exogenously. See ACIL Tasman, op. cit., A-6, for more details of CPI in the model.

48 See PNG Government Department of Treasury, op. cit., 2012 Budget: Economic Outlook, 25.

49 Barker, op. cit., PNG's Economy 2010, 10.

50 See PNG Government Department of Treasury, op. cit., 2012 Budget: Economic Outlook, 33.

51 Ibid., 33.

52 ACIL Tasman, op. cit., 32.

53 Dixon, Kauzi and Rimmer, op. cit., 154.

54 ACIL Tasman, op. cit., 33.

55 Dixon, Kauzi and Rimmer, op. cit., 154.

56 Ibid., 153.

57 Ibid., 153.

58 ACIL Tasman, op. cit., 32-33.

59 Dixon, Kauzi and Rimmer, op. cit. 154.

of PNG has reported that shipping costs alone have increased in the last five years by 1000 per cent, which is very bad news for the country's other key export sectors, forestry, agriculture and fisheries industries. The non-mining and petroleum export sectors are also contending a 40 per cent surge in the number of

competitive imports, due to the appreciating kina and PNG's failing infrastructure.⁶⁰

Labour Market

The model simulation by ACIL Tasman also measures the impact of PNG LNG on aggregate employment levels. Given that the model classifies the oil and gas sector as primarily an urban-based industry, it is not surprising that positive results are found for skilled and unskilled urban employment levels, the model measuring increases of 61 per cent and 31 per cent respectively in the short run, with very similar outcomes for the long-run scenario.⁶¹ The 2012 National Budget indicates that there has, as predicted, been growth in employment for 2011, led especially by growth in the transportation sector experienced as a result of the Project.⁶²

However, the Monash Study disagrees with the analysis of ACIL Tasman over whether the Project will have long-run employment benefits for the country.

Proponents of projects such as the one being considered in this paper often claim that there will be significant increases in aggregate employment. Our modelling does not support this claim. While we would expect the LNG Project to affect wage rates for skilled and unskilled workers, we would not expect it to have an identifiable long-run effect on the overall level of employment, as many jobs will be lost in adversely affected industries as are gained in expanding industries. Employment in the long run depends on population growth and participation rates, neither of which will be affected significantly by the LNG Project.⁶³

Furthermore, the geographical distribution of these labour market impacts must be considered. Rural employment levels are expected to decline as a result of the Project. There is no doubt that hardest hit by Project-induced changes to the labour market will be the unskilled rural workers who constitute the majority workforce in PNG's smallholder agriculture sector. In addition, the shift in industrial composition (contraction in other export-oriented industries, most notably agriculture, forestry and mining primarily employing unskilled rural workers, and expansion in domestically-oriented industries, especially the services sector employing majority urban-based skilled workers), will see increasing demand for the latter driving up wages for PNG's skilled workforce, while the pay packets of unskilled rural Papua New Guineans can be expected to drop.

60 PNG Industry News, Dutch Disease Spreads (12 October 2012) <http://www.pngindustrynews.net/storyview.asp?storyid=9639392>

61 ACIL Tasman, op. cit., 34.

62 See PNG Government Department of Treasury, op. cit., 2012 Budget: Economic Outlook, 22.

63 Dixon, Kauzi and Rimmer, op. cit., 153.

The EIS concedes this could worsen poverty:

Although we do not directly address the issues of poverty and income inequality in the modelling, the results show a reduction in employment in rural areas where agriculture and forestry are important economic activities. This in turn implies that, in the absence of effective policies to address these pressures, there is

a risk that incomes will fall in those regions, thereby increasing poverty.⁶⁴

In summary, the positive predictions within the official EIS about the indirect benefits of the Project for the broader PNG economy stand up poorly under scrutiny: the model employed to predict the multiplier effects is based on unrealistic assumptions unfit for making forecasts; the touted large boost to GDP has been dismissed by other sources as irrelevant to the net welfare benefit to PNG; and the outlook for PNG's trade balance, exchange rate, sectoral impacts and labour market is challenged by other sources.



Raniolo house, PNG. Photo credit: Stephanie Lusby.

3.3 FISCAL RESTRAINT VERSUS DEVELOPMENT SPENDING: A DIFFICULT TENSION

As the 'resource curse' phenomenon demonstrates, the relationship between natural resource wealth and economic growth in the vast majority of developing country cases is not a positive one. Evidence from those countries that do manage to defy the trend suggests that one of the most important indicators influencing the correlation is 'government

64 ACIL Tasman, op. cit., 36.

effectiveness'.⁶⁵ After all, a resource windfall such as that associated with the PNG LNG is always subject to unavoidable uncertainties, given its dependence on the international commodity price and exchange rate, and its vulnerability to exogenous shocks. Therefore, rigid fiscal management of the resource rents cannot be overemphasised.

Nor can the importance of government expenditure policies to counter the negative effects of intense pressure on the domestic economy, including the harm caused to other export sectors through the appreciation of the national currency.

The ACIL Tasman EIS acknowledges that the macroeconomic outlook for PNG ultimately depends upon the effective management of government expenditure. However, in the opinion of Jubilee Australia, the authors largely gloss over this fiscal pressure; on this point the inconsistencies in the official EIS are perhaps most clearly exposed. On the one hand, the executive summary relishes the potential of a 'trickle down' benefit for all:

[...] the benefits from the Project would spread throughout the economy as the government applies the earnings from its substantial share in the Project to social and economic programs. These programs have the potential to improve the quality of life of Papua New Guineans by providing essential services and enhancing the country's productivity.⁶⁶

On the other hand, within the appendix of the Study can be found a strong caution against a pro-development spending strategy. Given the weak linkages between the gas sector and the rest of the economy, there will likely be pressure on the Government to stimulate job creation in the early years of the Project. However the authors predict that a large increase in development expenditure could result in an economic outcome akin to the 1990s boom and bust.⁶⁷ Modelling a scenario in which the PNG Government diverts its projected 91 per cent increase in tax intake into consumption expenditure, they find that GDP increases by 32 per cent (reduced from the 99 per cent predicted in the main model simulation), the real exchange rate increases by up to 20 per cent in the long run (resulting in significant erosion of international competitiveness of PNG exports), aggregate foreign exports decline by 14 per cent and aggregate foreign imports increase by 987 per cent. In short, a significant trade deficit and even more severe Dutch Disease effects would result, with smallholder agriculture cash crop production particularly hard hit.⁶⁸ The Appendix adds:

The foregoing simulation results indicate that a large increase in government expenditure could have effects similar to those of the resource boom [...] A far better strategy is to increase investment expenditure which builds up the physical and human capital base. Such a strategy has the

potential to yield high returns long after the oil and gas resources have been depleted.⁶⁹

In other words, the Government should be careful not to spend PNG LNG revenues on meeting the public's expectations for imminent improvements in key development areas, lest it find itself again in the economic mess of the 1990s. Yet this precautionary approach bears little resemblance to the 'gung-ho' predictions earlier in the Study.

The Monash Study, in contrast, addresses this tension explicitly; it models the effects of three different fiscal strategies potentially adopted by the PNG Government:

- a conservative strategy wherein the government increases national savings and accumulates foreign assets in the early years of the Project up until 2024, after which time a more relaxed fiscal policy can allow the foreign assets to be run down;
- an aggressive strategy in which the government decreases national savings and accumulates debt during the early years of the Project to fund a rapid increase in spending, before eventually tightening fiscal policy so as to increase savings and repay debt;
- a passive strategy in which fiscal policy is neutral, where the government spends at the same rate it earns, with no change in foreign assets or liabilities.⁷⁰

Implicit in all three policy scenarios is an acknowledgement of the tension facing the PNG Government in terms of its spending. The modelling indicates firstly, that under all scenarios PNG cannot avoid significant real appreciation during the construction phase of the Project (2010 to 2014) and therefore, the problem of Dutch Disease. Secondly, if the government wishes to avoid consistently high inflation levels, it will need to adopt a conservative expenditure policy.⁷¹

In summary, the prospect of worsening poverty and living conditions for rural Papua New Guineans is very real, and hinges on the successful design and implementation by government institutions of expenditure policies to counter the LNG-induced negative impacts on the agriculture and forestry sectors in particular. At the same time, the inflationary pressure already present in the economy means that even the smallest increase in government spending will exacerbate aggregate demand and overheat the economy.

From the speech delivered by the Minister for Treasury and Finance when presenting the 2012 National Budget to the Parliament, it appears that even some within the Government recognise the need to dampen public expectations of what PNG LNG revenues can deliver:

It is important that our expectations are realistic. Even when we look ahead to beyond 2015 when PNG LNG revenue starts flowing, we see that there will not be as much money as many people think. PNG LNG revenues will be important, but they will simply replace mineral revenue from

65 Atsushi Iimi, *Did Botswana Escape from the Resource Curse?*, IMF Working Paper (WP/06/138), 2006.

66 ACIL Tasman, op. cit., v.

67 Ibid., A-9.

68 Ibid., A-9.

69 Ibid., A-9.

70 Dixon, Kauzi and Rimmer, op. cit., 145-146 and 155.

71 Ibid., 152 and 155.

projects which are winding down or becoming less profitable. Money does not grow on trees, and for all of its importance, the PNG LNG Project is not a magic saviour to the PNG economy.⁷²

SUMMARY FINDINGS

- Based on the official Economic Impact Study, the Project's proponents have touted overly-rosy economic projections for PNG. Upon closer scrutiny, the direct effects are modest in terms of the net benefit to the PNG economy. The model employed by the EIS to predict significant indirect benefits is based on unrealistic assumptions unfit for making forecasts.
- The EIS is internally inconsistent in its discussion of PNG's fiscal tension: the magnitude of impact on the broader economy means that a positive or negative macroeconomic outlook hinges on the PNG Government having a sound long-term plan for fiscal management, and an effective mechanism for spending revenues on the social and economic infrastructure needed for sustained growth. Yet due to the inflationary pressure already present in the economy, an increase in development expenditure could overheat the economy and, if not tightly-controlled, return PNG to the economic mess of the 1990s.
- The most recent economic indicators from PNG, released just before publication of this report, show the PNG LNG Project already creating large, damaging ripple effects in the rest of the economy. Dutch disease is spreading, causing significant harm to the country's non-mining and petroleum export sectors.
- The economic boost provided by PNG LNG will not be sufficient to see the country transform its gas wealth into growth and development. As has been clearly demonstrated over recent decades in PNG, and in other resource-abundant developing countries, only sound political institutions and strong governance can prevent the resource wealth from being rapidly exhausted. These factors will be discussed in the next Chapter.

⁷² Don Pomb Boyle, PNG Minister for Treasury and Finance, 2012 Budget Speech: Sharing the Wealth and Empowering our People, 6 December 2012, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/Speech/budget.speech.2012.pdf, 22.

4 THE POLITICAL CHALLENGES OF ACCOUNTABILITY

4

Officials and spokespeople from the PNG and outside Governments, along with the Companies involved, have generally maintained a strongly optimistic tone regarding the capacity of PNG to meet the governance challenges presented by PNG LNG. The Australian Government, for example, has expressed confidence that the establishment of a well-designed Sovereign Wealth Fund will ensure 'effective and transparent governance' of the resource rents, and thereby deliver benefit for all Papua New Guineans. The Trade Minister, in announcing the Australian Government's investment decision in December 2009, said:

[...] the Australian Government, with the PNG Government, is focussed on ensuring that the project lives up to its potential, and benefits all regions and people of PNG. I have agreed a Joint Understanding with the PNG Government on effective and transparent governance of the LNG Project revenue. The Joint Understanding sets out the PNG plans to develop a Fund based on the Australia Future Fund model with Australian assistance.¹

But is this optimism justified? As has already been shown, PNG faces a serious fiscal challenge in managing the Project rents so as to mitigate harmful effects on the remainder of the economy. What cannot be overemphasised is the fact that the transformation of the extensive Southern Highlands gas reserves into broad-based growth and development is a deeply political issue. When it comes to PNG's past experience in the political management, or perhaps more correctly the mismanagement of natural resource revenues, the country has a long history. Sovereign Wealth Funds also have their own history in PNG.

This chapter asks what evidence exists to support the optimistic view, as mentioned above, that the institutional framework set up to manage the PNG LNG windfall is up to the task? Will the outcomes be different from those in the past? How effective are the reforms that have been put in place? Can and will they last?

4.1 INSTITUTIONAL FRAMEWORK FOR MANAGEMENT OF LNG PROJECT REVENUES

MANAGEMENT OF TAXATION REVENUE

The principal income stream to the National Government will be taxation revenue, with the lion's share generated from the 30 per cent corporate tax.

This will be supplemented by other taxes such as an additional profits tax (similar to a resource rent tax), petroleum tax, withholding tax, import and stamp duties, and a payroll tax.² Projected National Government taxation revenue will total K66,991 million over a 30 year project life.³

After tax is collected by the National Treasury, it is placed in the Consolidated Revenue Fund before being deposited into the Sovereign Wealth Fund's Stabilisation Fund.⁴ However, without the PNG Government's adoption of the Extractive Industries Transparency Initiative (EITI), it will not be possible to verify that the amount paid in tax by ExxonMobil on behalf of the PNG LNG Companies matches that recorded as being received by the National Treasury (see Section 4.4 below for The Case for EITI).

MANAGEMENT OF PNG'S COMMERCIAL INVESTMENT IN THE PROJECT

As was outlined in Chapter 2, alongside the Companies, the PNG Government and Landowners own a 19.6 per cent equity share in the PNG LNG Joint Venture. The state-owned entity Petromin PNG Holdings LTD holds 0.2 per cent Project equity through a stake in the Moran field, while the Mineral Resource Development Company (MRDC) holds the Landowners' 2.8 per cent share (discussed further in Chapter 5). The bulk of the State's equity, 16.6 per cent, is held under the Independent Public Business Corporation (IPBC) through a subsidiary called the National Petroleum Company of PNG (NPCP), formerly known as Kroton No. 2. The total 19.6 per cent equity stake was projected to derive, at 2008 prices, more than K37 500 million over the life of the Project.⁵

The various institutions through which these different revenue streams are collected, protected, managed and spent will be crucial to the success or otherwise of the Project for the people of PNG. Therefore the remainder of this chapter will examine these institutions and processes in some detail, turning first to the institution at the centre of the collection and management of the dividend revenues: the IPBC.

¹ Simon Crean, Media Release: Australian Government Support for Gas Project in PNG, 8 December 2009, http://www.trademinister.gov.au/releases/2009/sc_091208.html.

² Independent State of Papua New Guinea, op. cit., Oil and Gas Act 1998, Section 13.4. The Additional Profits Tax (APT) is similar to a resource rent tax (RRT). Tax liabilities are incurred when a company reaches a defined threshold rate of return on funds invested. The APT is applied to all profits once the company has recovered capital, plus a designated rate of return. For more information see Ciaran O'Faircheallaigh, "Mineral Taxation in Less Developed Countries: Papua New Guinea's Balanced System," *American Journal of Economics and Sociology* 34, no. 3 (July 1986), 291-294. It is unclear whether payroll taxes from PNG LNG will be separated from general payroll tax income and subject to special management.

³ Goldman, op. cit., Social Impact Assessment, 1-26.

⁴ Independent State of Papua New Guinea, Public Finance (Management) Act 1995, http://www.paclii.org/pg/legis/consol_act/pfa1995224/, Part III.

⁵ Goldman, op. cit., Social Impact Assessment, 1-27.

The principal income stream to the National Government will be from taxation revenue, with the lion's share from the 30 per cent corporate tax, petroleum tax, withholding tax, import and stamp duties, and a payroll tax.

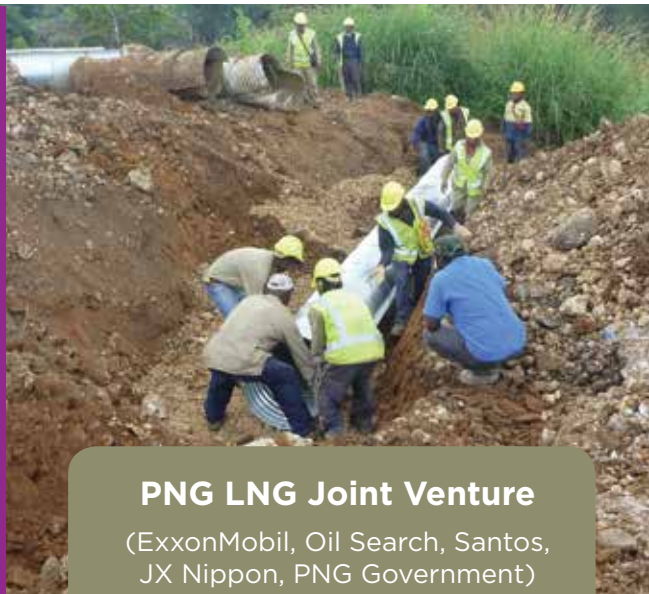
After tax is collected by the National Treasury, it is placed in the Consolidated Revenue Fund before being deposited into the SWF Stabilisation Fund. However, without the PNG Government's adoption of the Extractive Industries Transparency Initiative (EITI), it will not be possible to verify that the amount paid in tax by ExxonMobil on behalf of the PNG LNG Companies matches that recorded as being received by the National Treasury (see Section 4.4 below for The Case for EITI)

All mineral and petroleum revenues are to be paid into the Stablisation Fund, including PNG LNG Project dividends and revenue from taxation.

The Development Fund, on the other hand, is intended to hold an ongoing source of funding for social and economic development.

All funds drawn down from the Stablisation Fund should flow through the National Budget. A defined amount (determined by an Act of Parliament) will be withdrawn from the Stablisation Fund and deposited into the Budget on an annual basis, before being deposited in the Development Fund.

Rather than receiving direct revenue deposits, the Development Fund is to receive a defined amount (determined by Parliament) from the Stablisation Fund each year.



PNG LNG Joint Venture

(ExxonMobil, Oil Search, Santos, JX Nippon, PNG Government)

TAXATION revenue

Projected National Government taxation revenue is K66.991 million over 30-year Project life.

State Consolidated Revenue Fund

EQUITY PARTNERSHIP revenue

Dividend revenue from total Government 19.6% equity stake projected to derive at 2008 prices, more than K37,500 million over the life of the Project.

National Petroleum Company of PNG (NPCP)

Independent Public Business Corporation (IPBC)

Stablisation Fund

Development Fund

National Budget

Alongside the Companies, the PNG State and Landowners own a 19.6 per cent equity share in the PNG LNG Joint Venture. The State-owned entity Petromin PNG Holdings LTD holds a 0.2 per cent Project equity through a stake in the Moran field, while the Mineral Resource Development Company (MRDC) will manage the Landowners' 2.8 per cent share in combination with the relevant Landowner groups (discussed further in Chapter 5). The bulk of the State's equity, 16.6 per cent, is held under the Independent Public Business Corporation (IPBC) through a subsidiary called the National Petroleum Company of PNG (NPCP) formerly known as Kroton No.2.

Kroton No.2 was established as a state-owned public enterprise in June 2010 with an independent Board and management. It was principally created to serve as an operating company in the PNG LNG Joint Venture to hold the State's main equity share in the Project. Kroton No.2 was subsequently renamed the National Petroleum Company of PNG (NPCP). The NPCP will collect the dividend payments from PNG LNG on behalf of the State and Landowners, and pass them through the IPBC.

In 2008, the Independent Public Business Corporation (IPBC) was named as trustee for Kroton No.2, the company mandated to acquire the largest of the State's equity shares (16.6 per cent) in the PNG LNG Project. After retaining funds for its operational costs, the IPBC will transfer the income from PNG LNG dividends into the Stablisation Fund.

The new O'Neill Government, however, instigated a considerable shake up to the original structure of the NPCP and IPBC. Following approval by the National Executive Committee (NEC) in November 2011, the NPCP Board and management was dismantled with core functions transferred to a Project management unit under the IPBC. The NPCP mandate was wound back to that of a passive stakeholder (Shell company) in the PNG LNG Joint Venture.

Figure 6: Institutional framework for national government revenue flows

4.2 INDEPENDENT PUBLIC BUSINESS CORPORATION (IPBC)

The Independent Public Business Corporation (IPBC) was created by legislation in 2002⁶ as an independent entity to act as sole shareholder on behalf of the Government in state-owned public enterprises, including Air Niugini Limited, National Development Bank, PNG Power Limited, PNG Waterboard and Telikom PNG Limited. The IPBC also manages the Government's minority shareholding in listed companies, such as Oil Search Limited, Bank of South Pacific Limited and New Britain Palm Oil Limited.⁷ In 2008, the IPBC was named as trustee for Kroton No. 2 Limited, the company mandated to acquire the largest of the State's equity shares (16.6 per cent) in the PNG LNG Project.⁸ Under the 2002 legislation, the relevant state-owned public enterprises are required to pay an annual dividend to the IPBC. After retaining funds for its operational costs, the IPBC passes the dividends from both the public enterprises and the commercial investments to the Consolidated Revenue Fund for Budget prioritisation.⁹ It was envisaged that the IPBC would provide publicly funded services to help enhance the financial position of PNG's public enterprises, in so doing maximising this return on public assets.

Though relatively short, the history of the IPBC has been troubled. At its formation, attempts were made by the Morauta Government to implement legislatively mandated quarterly business reporting, restrictions on outsourcing of management, and financial operating rules. Yet many of these accountability provisions were wound back through amendments to the Act under the Ministerial reign of Arthur Somare from 2006,¹⁰ including removal of sections requiring independence from political interference and independent auditing by the Auditor-General. What resulted were conflicts of interest on the Board, expanded Director powers and eroded transparency and accountability.¹¹ These problems were compounded by the discretion and flexibility afforded to the Board in determining the profit remitted or paid to the PNG Government.¹² Between 2002 and 2007, large public enterprises held in trust under the management of IPBC contributed a mere K48 million in dividends back to the State; since

2007 this amount has fallen to zero.¹³ The obvious question raised is - where did the dividend revenues go?

THE IPBC'S RECENT RESHUFFLE

The IPBC is now very much at the front and centre of PNG LNG revenue management. In November 2011, following a review of the IPBC conducted under the new O'Neill Government, a restructure was announced in which the National Executive Council decided to rescind earlier decisions to extend the role and powers of NPCP, including dismissing the independent Board; instead the mandate of the NPCP was wound back to that of a passive asset holding stakeholder (shell company) in the Joint Venture.¹⁴ Preceding this shake-up was the appointment in mid-2011 of former Prime Minister Sir Mekere Morauta to the post of Minister for Public Enterprises. Morauta contended that the decision to adjust the institutional arrangements was taken in the national interest - an effort to reduce waste and costs by removing the 'middle man' between the Project and IPBC.¹⁵

Three issues have come strongly to the fore since this reshuffle and Morauta's ascension to a position of control over the IPBC. First, some Landowners in the key Hela Province have expressed anger that they were not consulted before this substantial change, especially given that the NPCP's management of their share in the equity stake formed part of the original agreement. They fear that with the scaling back of the NPCP's role, any leverage they may have had to influence the Project as a result of their equity share has been lost.¹⁶ The Minister's reply to this concern is, in the opinion of Jubilee Australia, rather curious, given that there is no longer any opportunity for disgruntled Landowners to negotiate an alternative deal:

The purpose of IPBC, including NPCP/Kroton, is only to hold state assets. It is not an operating company. All it does is distribute the dividends from the equity - to the State and to the landowners. If the landowners want to enter into a joint venture they can do so through Petromin, or MRDC or a private company.¹⁷

Second, have been the public comments made by Morauta about the IPBC's involvement in the PNG LNG loan liability. In numerous public statements since taking over as Minister for Public Enterprises, Morauta has alleged incompetence on the part of the previous Somare Government and former IPBC management for taking on such a large liability. Not only was the loan drawn down in Australian dollars when in fact US dollars are required for the PNG LNG equity payments, with the costs incurred through conversion, it is

6 Independent State of Papua New Guinea, Independent Public Business Corporation of Papua New Guinea Act 2002, http://www.paclii.org/pg/legis/consol_act/ipbcopnga2002569/.

7 Independent Public Business Corporation, State Owned Entities, <http://www.ipbc.com.pg/portfolio.html>.

8 Independent Public Business Corporation, PNG Liquefied Natural Gas Project, 14 October, 2011, <http://www.ipbc.com.pg/pnglng.html>.

9 PNG Government Department of Treasury, 2012 Budget: Improving Public Enterprises and Commercial Investment Performance, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/Volume1/chapters/vol1_chapter8.pdf, 99.

10 See recent parliamentary questioning of the former NA Government about IPBC by Mereke Morauta. Malam Nalu, "Question without notice by Sir Mekere Morauta on the Independent Public Business Corporation," 19 June 2009, <http://malumnalu.blogspot.com/2011/06/question-without-notice-by-sir-mekere.html>.

11 Simon Erero, "\$39.3 Million PNG Dividends Never Recorded," Pacific Island Report (September 2011), <http://pidp.eastwestcenter.org/pireport/2011/September/09-08-06.htm>. See also PNG Government Department of Treasury, op. cit., 2012 Budget: Improving Public Enterprises, 101.

12 Independent State of Papua New Guinea, op. cit., Independent Public Business Corporation of Papua New Guinea Act 2002, Section 35. See also Timothy Curtin, "Privatisation Policy in Papua New Guinea", in Policy Making and Implementation: Studies from Papua New Guinea, ed. Ron May (Australian National University E Press, 2009), http://eprint.anu.edu.au/ssgm/policy_making/.

13 Mekere Morauta, "The theft and waste of public money in Papua New Guinea's Public Enterprises," Act [...] Now For a Better Papua New Guinea, <http://actnowpng.org/content/theft-and-waste-public-money-papua-new-guineas-public-enterprises>.

14 Papua New Guinea Ministry of Public Enterprises, Public Statement: National Petroleum Company of Papua New Guinea, 18 November 2011, http://www.ipbc.com.pg/PDF_files/20111114%20PS%20Min%20NPCP.pdf.

15 Mekere Morauta, Ministry of Public Enterprises, Public Statement: NCP Landowners, 23 November 2011, http://www.ipbc.com.pg/PDF_files/20111123%20MS%20NCP%20landowners.pdf.

16 Malam Nalu, Sir Mekere Morauta answers questions on National Petroleum Company (23 November 2011), <http://malumnalu.blogspot.com.uk/2011/11/sir-mekere-morauta-answers-questions-on.html>.

17 Ibid.

alleged, responsible for a shortfall¹⁸; Morauta claims that in negotiating the loan, the Treasury was shut out by former Minister for Public Enterprises Arthur Somare and the former IPBC management¹⁹, who, it is argued, negligently agreed to repay the loan in full by March 2014, before the Project has started to produce significant revenue for the Government.²⁰ Similar claims were made in 2009 by the PNG Auditor-General, whose Report of that year noted that the signed loan agreement between NPCP and IPBC, which agreed that the funds advanced to NPCP would be refunded, was not made available to him in order to verify its terms and conditions.²¹

Third, in recent months, Morauta has gone even further by publicly accusing his predecessor and the former IPBC management of gross misconduct. Morauta said in a public statement:

It seems that the IPBC and its SOEs were seen as the Somare family 'honey pot', with family members and cronies being appointed to the boards of SOEs and IPBC, and deals being done which make no commercial sense, and which have proven to be of little or no benefit to the public. In the midst of this, the family financial adviser was appointed as Managing Director of IPBC (no conflict of interest was apparently noticed) and even the Somare family legal adviser was given chairmanship of IPBC for a period. As Minister, Arthur Somare regarded the SOEs as toys to be owned to glorify his image, not to provide services to people.²²

To conclude, in the context of so much political heat surrounding the past and future activities of the IPBC, a number of encouraging reforms have been implemented. Sir Mekere appointed a new Managing Director and Board to the IPBC and claims that from now on the IPBC will fulfil its legislative requirements, including conducting audits, drafting an annual business plan and making investment decisions transparent. The Government has also made a commitment that the Dividend Policy (outlining the agreed dividend stream to be paid by the IPBC into the Consolidated Revenue Fund) will be made public.²³ This increases the chances that PNG LNG dividend flows from the IPBC into the Stabilisation Fund will also be publicly disclosed. Furthermore, in March 2012, the National Executive Committee (NEC) approved amendments to the IPBC Act, including the reinstatement of some of the key accountability provisions removed by Somare.²⁴ While such changes give reason to be more optimistic, the effectiveness of the reforms has yet to be tested. Neither can it

be assumed that such reforms will be maintained by successive governments.

From a longer term perspective, we might suspect that the apparent clash of agendas previously exposed between Peter O'Neill and Sir Mekere Morauta may resurface in the management of the PNG LNG revenues, given the two now hold the key positions of Prime Minister and Minister of Public Enterprises respectively. As will be discussed further in chapter 5, a leaked memo from December 2010 suggests the new Prime Minister was one of three, including the previous PM Michael Somare, to direct the Secretary of Planning to make unbudgeted payments from the PNG LNG revenues worth K98 million, to shore up support for the Prime Ministers among MPs.²⁵

4.3 THE CASE FOR EITI

Depositing the revenue windfall from a project such as PNG LNG into a dedicated account is an essential step for the PNG Government to take. But aside from such a new and specifically designed Sovereign Wealth Fund, how can it be assured that the PNG LNG rents will reach the Fund in the first place? This question not only exposes the significance of the IPBC's role in the collection and deposit of the dividend income into the Stabilisation Fund; it also brings into the light the need for accountability and effective oversight along the entire PNG LNG revenue chain. This brings us to the matter of the EITI.

The Extractive Industries Transparency Initiative (EITI) is the leading global voluntary standard for transparency in the mineral, oil and gas sectors. Launched in 2002, EITI is a coalition of governments, companies, civil society groups, investors and international organisations, who have committed to international standards that require signatory governments to report publicly on the receipt of royalty, dividend and taxation payments from companies, so as to reduce opportunities for corruption and waste by State officials.

The general principle of the EITI is that all 'material benefits streams must be reported'. The materiality threshold is determined on a country-by-country basis with EITI working groups collectively making a decision on what revenue streams are material and significant in the context of their overall extractive industry-based income.²⁶ Reconciliation of payment and receipt information by an administrator is reported publicly, providing an opportunity for all stakeholders to consider any unresolved discrepancies in payment or receipt of resource revenues.²⁷ Through this full verification and publication of company payments on the one hand, and government receipts on the other, citizens, government, and civil society can 'shine the light of transparency on extractive industries' and aid

18 Papua New Guinea Ministry of Public Enterprises, Public Statement: LNG Loan Shortfall, 24 November 2011, http://www.ipbc.com.pg/PDF_files/20111115%20PS%20LNG%20loan%20shortfall.pdf.

19 Ibid.

20 Mekere Morauta, The theft and waste of public money in Papua New Guinea's Public Enterprises, Act [...] Now For a Better Papua New Guinea, <http://actnowpng.org/content/theft-and-waste-public-money-papua-new-guineas-public-enterprises>.

21 Papua New Guinea Auditor-General, "Section A: Public Bodies and their Subsidies," Report of the Auditor General 2009, 10 October 2010, <http://www.ago.gov.pg/docs/reports/PART%20IV%202009%20Section%202.pdf>, 53.

22 Morauta, op. cit., The theft and waste of public money.

23 PNG Government Department of Treasury, 2012 Budget: Improving Public Enterprises and Commercial Investment Performance, op.cit., 100.

24 "NEC Amends IPBC Act," The National, 13 March 2012, <http://www.thenational.com.pg/?q=node/30186>.

25 "Planning Secretary details government misuse of K98 million to buy support," PNGexposed Blog, 2 February 2011, <http://pngexposed.wordpress.com/2011/02/02/planning-secretary-details-government-misuse-of-k98-million-to-buy-support/>.

26 For a description of what revenue streams are generally included in EITI reports, see EITI Secretariat Extractive Industries Transparency Initiative: Source Book (2005), 26-29.

27 Alison Paul De [...] Schryver and John Johnson, EITI Guide for Legislators: How to Support and Strengthen Resource Transparency (National Democratic Institute, 2009), 15-16.

BOX 4.1: THE SUCCESS OF THE EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

The Extractive Industries Transparency Initiative has been implemented in a number of countries. Those verified as EITI compliant include Mongolia, Azerbaijan, Kyrgyz Republic, Ghana, Nigeria, Mali, Liberia, Timor Leste and Norway.²⁸ Countries in the process of implementing the EITI but that have not been validated as adopting all EITI principles and guidelines are described as EITI candidate countries. Candidates currently include Cameroon, Chad, Democratic Republic of Congo, Guatemala, Iraq, Indonesia, Sierra Leone, Peru, Kazakhstan, Tanzania, Zambia and most recently, the Solomon Islands.

The outcomes of EITI implementation can vary due to the diverse domestic circumstances in which EITI is deployed.²⁹ Independent review of three EITI compliant countries—Mongolia, Nigeria and Gabon—show an increasing public desire for information about resource revenues, greater engagement between stakeholders who could not or would not speak to each other previously, and signs of improving transparency. Over the longer term, more significant improvements in political culture, transparency and accountability are expected. In sub-Saharan African countries, particularly Liberia, Democratic Republic of Congo and Chad, evidence suggests that EITI implementation may have specific outcomes in terms of conflict prevention; whereas in Central Asian countries, there has been greater focus on EITI's positive anti-corruption outcomes.

In general, implementation of EITI can be attributed to improved governance, empowerment of civil society, improved business climates and assistance in enhancing governmental capacity to manage growth and development in EITI compliant countries.³⁰ Most importantly, the initiative aims to increase transparency of payments, thereby reducing opportunities for corruption and misappropriation of public funds.

Evaluating the EITI in terms of its contribution to “transforming economies, reducing

poverty and raising living standards’ is more difficult³¹ The EITI can improve transparency of revenues paid to governments, but it does not necessarily and directly enhance the quality of how governments spend public income. Drawing this connection is particularly challenging, but it should not detract from the cultural and institutional impact of revenue transparency that lays the foundation for improving the quality of government expenditure.

Recent comments published in The Guardian from Bishop Stephen Munga, a member of the Tanzanian EITI multi-stakeholder working group, speak for themselves:

The first EITI report was launched in Tanzania last year [2011] and prompted heated public debate. People were able to peruse previously unseen facts and figures. On the one hand, the report confirmed public suspicions of cheating in the natural resources business; on the other, it raised hopes that the truth is now partly visible and can be used to effect change. [...] Tanzanians have managed to create platforms for discussion with our politicians. We know our government is under pressure from civil society to make the mining sector function for the benefit of communities. The more information available, the better the quality of public debate will be. We will be able to convince government to enter business deals with credible partners, those prepared to go the extra mile on increasing transparency.³²

those seeking to hold governments accountable for resource revenues.³³

PNG AND THE EITI

To date the PNG Government has declined to take advice to join the EITI from both internal and external proponents. In 2005, the Government even rejected an offer of LNG Project financing from the Asian Development Bank (ADB) allegedly on the grounds that the Bank's support was conditional upon the country's implementation of the EITI.³⁴

What has been the position of ExxonMobil regarding EITI implementation in PNG? ExxonMobil is an EITI-supporting company. Having occupied a seat on the EITI Board between 2006 and 2009, the company

28 For a full list of EITI-Compliant countries, see Extractive Industries Transparency Initiative, EITI, <http://eiti.org/countries>.

29 For an appraisal of EITI implementation and development see Scanteam, op. cit., 9-35. For a critique of the effectiveness of EITI and the soft law nature of CSR and transparency measures see Bede Nwete, “Corporate Social Responsibility and Transparency in the Development of Energy and Mining Projects in Emerging Markets; Is Soft Law the Answer?,” *German Law Journal* 311 (2007), 313 and 327-332.

30 For example see Christopher Eads and Anders Kråkenes (eds.), *Impact of EITI in Africa: Stories from the Ground*, (Norway: EITI International Secretariat, 2010), <http://eiti.org/document/impact-africa>. See also Scanteam, *Achievements and Strategic Options: Evaluation of Extractive Industries Transparency Initiative*, Final Report, (Norway: EITI International Secretariat, 2011), <http://eiti.org/files/2011-EITI-evaluation-report.pdf>.

31 See Scanteam, op. cit., 27-36.

32 Bishop Stephen Munga, ‘Greater transparency can shed light onto the murky world of resource corruption,’ *Poverty Matters Blog*, The Guardian, 30 March 2012, <http://www.guardian.co.uk/global-development/poverty-matters/2012/mar/30/greater-transparency-resource-corruption?intcmp=I22>.

33 De [...] Schryver and Johnson, op. cit., 13.

34 The ADB was formally requested to consider funding PNG's \$328 million equity participation the 2005 PNG Gas Project, which for the most part was the same proposal as the PNG LNG Project except that the pipeline would extend to Australia for sale of the gas. See Asian Development Bank. *Technical Assistance Papua New Guinea: Preparing the PNG Gas Project*, December 2005, <http://www2.adb.org/Documents/TARs/PNG/39584-PNG-TAR.pdf>.

continues to serve as a Board alternate. While the company has been involved in the establishment of transparency agreements, including assisting in the implementation of EITI in a number of countries in which it operates (Azerbaijan, Chad, Equatorial Guinea, Indonesia, Iraq, Kazakhstan and Nigeria), no such agreement has been reached in PNG.

On a positive note, the PNG Government included for the first time in its most recent Budget Papers a recognition of the need for improved transparency, accountability and governance in the management of resource revenues, and a commitment to examine further PNG's implementation of the EITI through a State Working Group, chaired by Treasury, with the assistance of the World Bank.³⁵

Simply put, there are no good reasons why the government should resist EITI implementation. In addition to sending a positive message to PNG citizens and the world about its commitment to equitably sharing the PNG LNG wealth, joining the EITI will:

- ensure the proceeds of resource projects including the PNG LNG are transparently collected and deposited in the Sovereign Wealth Fund;
- reduce the opportunity for misappropriation by stakeholders, government bureaucrats and politicians;
- provide the opportunity for the participation of PNG's civil society in direct monitoring;
- mitigate the potential for dissatisfaction amongst people in the Project-affected areas by demonstrating that the proceeds of PNG LNG and other resource projects are being carefully managed;
- send a positive signal to international investors and thus lead to strengthened business confidence in PNG.

As noted above, transparency of PNG LNG resources requires disclosure along the entire chain. In this regard, it is important to highlight that while the EITI is the most effective method to facilitate verification of revenue information at a national level, the initiative does not enable local communities to know how much wealth has been received or should be disbursed by sub-national bodies. The proposal to extend the EITI model downwards is discussed further in Section 5.3.

³⁵ "The Government recognises the need for improved transparency, accountability and governance in dealing with the country's resource rents...The Government has approved the engagement of a State Working Group, chaired by Treasury, to work with World Bank Technical Assistance in developing a detailed implementation plan for the EITI concept in PNG. This detailed implementation plan will be presented to the NEC for consideration." PNG Government Department of Treasury, 2012 Budget: Building the Economy Through Sustained Reforms, Vol. 1, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/Volumel/chapters/vol1.chapter7.pdf, 95. Encouragingly, the 2012 Budget also says: 'EITI implementation could send a signal to grass root Papua New Guineans that they should have faith in the payments, receipts, and spending from extractive industry revenues. It could also make it easier to detect corruption by providing information on revenue and payments available to the public. EITI will also assist in managing corporate risks, especially to extractive industry companies, and thus, improve investor confidence in PNG. This could also assist the Government improve its sovereign credit rating (potentially leading to lower costs of borrowing).'



PNG courtroom. Photo credit: Antony Loewenstein.

BOX 4.2: WHAT ARE SOVEREIGN WEALTH FUNDS?

Sovereign Wealth Funds are special purpose investment vehicles created and owned by governments, established to achieve defined financial objectives through the investment of assets such as excess foreign reserves or revenue from the export of natural resources. Funds whose income is exclusively from natural resources are sometimes also known as Natural Resource Funds.³⁶

Governments may establish Sovereign Wealth Funds for a number of reasons. Primarily, the purpose is to save the revenue from non-renewable natural resources for future generations (supporting inter-generational equity). However, the stabilisation of exchange rate appreciation (to avoid Dutch Disease) and the management of inflationary pressures (to avoid cost of living increases) are also important reasons for the creation of such Funds.³⁷

Given these aims, a state or national Sovereign Wealth Fund is often made up of two separate funds: a short-term stabilisation fund and a longer-term savings funds. How do the two different funds work?

Stabilisation funds hold a variety of liquid and short-term assets that can be quickly mobilised should the government have a need for them. As revenues begin to flow, the windfall is directed into the stabilisation fund according to a predetermined fiscal rule and the level of mineral prices. Another rule dictates the amount of money in the fund that the government can access for budgetary purposes.³⁸

Savings funds operate quite differently: a fixed percentage of commodity revenues are directed into the fund each year. Again, there is a rule determining what percentage of the value of the

³⁶ International Working Group on Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices – "Santiago Principles," October 2008, <http://www.iwg-swff.org/pubs/eng/santiagoprinciples.pdf>, 3. Note that approximately 70% of non-pension SWFs receive is income from natural resources, primarily oil and gas. See Edwin Truman, Sovereign Wealth Funds: Threat or Salvation? (Washington D.C.: Peterson Institute for International Economics, September 2010), 20.

³⁷ Truman. Ibid., 10.

³⁸ Tsalik, op. cit., 33; Also Ashby Monk and Adam Dixon, "The Design and Governance of Sovereign Wealth Funds: Principles and Practices for Resource Revenue Management," Background Paper for the Asian Development Bank, 30 October 2011, 1.

fund may be transferred to the state budget every year.

Unfortunately, Sovereign Wealth Funds do not have a good history in PNG. The most notorious case is that of the Mineral Resources Stabilisation Fund (MRSF), PNG's first and, until now, largest Sovereign Wealth Fund. The MRSF was created in the 1970s to receive all tax, royalty and dividend payments from major mining and oil projects including Misima, Porgera, Kutubu and Tolakuma and Ok Tedi, and then over time, to ensure the smooth allocation and distribution of the funds through the budget.³⁹ The MRSF was heavily implicated in the financial mismanagement of the 1990s mining boom and was drained of all its resources by the turn of the century. There have also been allegations that Government Trust Accounts set up after the demise of the MRSF were also drained of some of their revenues. The stories of both these funds, as well as that of the PNGSDP, are told in more detail in Box 4.3. The notable failures of previous Sovereign Wealth Funds are well remembered today in PNG.⁴⁰

4.4 PNG AND SOVEREIGN WEALTH FUNDS

The scale of the expected PNG LNG revenues led PNG to announce its intention to set up new institutional architecture to handle the vast increase of export income.⁴¹ One of the steps leading to this commitment was the signing of a Joint Agreement with the Australian Government in 2009.⁴² In the following 2011 Budget, the Somare Government indicated its intention to set up an offshore-operated and -invested Sovereign Wealth Fund made up of three interrelated funds—a stabilisation fund, a future (savings) fund, and an infrastructure fund, to manage windfall revenue from the PNG LNG Project and other mineral and petroleum projects. See Box 4.2 for more information about what Sovereign Wealth Funds (SWFs) are and how they operate.

PNG'S NEW FUND

Since February 2011, the Secretaries' Committee established to oversee the establishment of PNG's new Sovereign Wealth Fund has been developing the policy for its structure and institutional framework, with some involvement of Australian Government officials.⁴³

³⁹ See Peter Johnson, *op. cit.*, 2.

⁴⁰ In his presentation of the 2012 Budget to the Parliament in late 2011, the Minister for Treasury and Finance cited the experience of MRSF as a warning, stating "... this Fund failed to meet its objectives, and the moneys initially saved were ransacked and wasted." Don Pomb Polye, PNG Minister for Treasury and Finance, 2012 Budget Speech: Sharing the Wealth and Empowering our People, 6 December 2012, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/Speech/budget.speech.2012.pdf, 20.

⁴¹ Department of Treasury and Bank of Papua New Guinea, *op. cit.*, Possible Creation of a Sovereign Wealth Fund, 4. See also a similar paper by the International Monetary Fund, "Papua New Guinea: Selected Issues Paper and Statistical Appendix," IMF Country Report No. 10/163, June 2010.

⁴² See Department of Foreign Affairs and Trade, Joint Understanding between Papua New Guinea and Australia on further cooperation on the PNG LNG Project, http://www.dfat.gov.au/geo/png/png_lng_091208.html.

⁴³ PNG Government Department of Treasury, 2012 Budget: The Establishment of a Sovereign Wealth Fund, Vol.1, http://www.treasury.gov.pg/html/national_budget/files/2012/budget_documents/Volume1/chapters/vol1.chapter13.pdf, 155.

By November of the same year, when the draft legislation, The Organic Law on the Sovereign Wealth Fund⁴⁴ was published, it became clear that under the new PNG Government there were changes to the model initially proposed. While the law only incorporates high-level policy issues, the more detailed aspects (including withdrawal rules and management of fund dispersal) will be established and can be amended through Acts of Parliament.

The key features of PNG's Sovereign Wealth Fund model include:

Onshore management

Unlike the proposal of the previous Government, the Sovereign Wealth Fund is to be managed onshore. Oversight will be by an independent Board, made up of six private sector members and an ex-officio member of the Treasury. Board members are not to be political candidates or members of Government at any level. Membership will be determined by an Appointments Committee composed wholly of PNG citizens. The Office of Sovereign Wealth Fund under the Department of PM and the National Executive Committee (NEC) will play a high-level oversight role. All direct expenditure of the Fund Board and Administrative Secretariat will be through the Budget, therefore decided upon by the PNG Parliament.⁴⁵

Offshore investment

All investments approved by the Board are to be invested in foreign assets. Funds must not be used to purchase PNG Government debts, to lend or invest domestically, or to provide government guarantees.⁴⁶

Structure

Rather than the original three-fund proposal, the Fund will consist of just two funds - a Stabilisation Fund and a Development Fund. The Stabilisation Fund is intended to manage the impact of fluctuation in mineral and petroleum revenues on both the PNG economy at large and on the national budget. All mineral and petroleum revenues are to be paid into the Stabilisation Fund, including PNG LNG Project dividends and revenue from taxation. The Development Fund, on the other hand, is intended to hold an ongoing source of funding for social and economic development. Rather than receiving direct revenue deposits, the Development Fund is to receive a defined amount (determined by Parliament) from the Stabilisation Fund each year.

Withdrawal Rules and integration into National Budget

Withdrawal from the Stabilisation Fund will be determined by the 15 year long-term moving average of mining and petroleum revenues as a share of non-mineral revenue. In other words, when the amount of mineral revenues as a share of non-mineral GDP

⁴⁴ "Organic Law on the Sovereign Wealth Fund," Papua New Guinea National Gazette, 2 November 2011, http://www.treasury.gov.pg/html/media_releases/files/2011/national.gazette_organic.law.on.swf.pdf.

⁴⁵ PNG Government Department of Treasury, *op. cit.* 2012 Budget: The Establishment of a Sovereign Wealth Fund, 155.

⁴⁶ 'Organic Law on the Sovereign Wealth Fund', *op. cit.*

is above the long term average, the excess mineral revenues may not be withdrawn from the Fund. All funds drawn down from the Stabilisation Fund should flow through the National Budget. As mentioned above, a defined amount (determined by an Act of Parliament) will be withdrawn from the Stabilisation Fund and deposited into the Budget on an annual basis, before being deposited in the Development Fund. It is stated that there will be a 'check and balance' on the process of funding being released from the Development Fund for both accounts. But details of this accountability process have yet to be released publicly.⁴⁷

ASSESSING THE EFFECTIVENESS OF THE NEW SOVEREIGN WEALTH FUND

Given the problematic history of Sovereign Wealth Funds in PNG, the claims about what PNG's new Fund can achieve, in terms of resource revenue management, need to be carefully assessed. We suggest the four criteria below to be particularly important in this evaluation.

(1) Transparency. It is frequently contended that a critical way to ensure that Sovereign Wealth Funds collect and manage revenues responsibly is to guarantee that they are administered in a transparent manner. It is this approach that has led to the establishment of the internationally-recognised Santiago Principles - 24 guidelines that establish what is said to be current best practice in the management and operation of Sovereign Wealth Funds.⁴⁸ These Principles include open and transparent governance, accountability mechanisms, disclosure of funding sources, appointment of an independent Board and consistent annual reporting and auditing.⁴⁹ Management processes (disclosure requirements matching those of a public company, annual and quarterly reports, announcement of tenders, publicised results of external audits, publicised minutes of Fund Directors meetings) are also thought to be helpful.

(2) Citizen Engagement. Increasing the participation of citizens in the oversight of a Sovereign Wealth Fund, it is argued, also provides an effective check on the action of Fund governors. An alert and engaged citizenry provides an invaluable check on the actions of the SWF governors. An independent multi-stakeholder oversight/monitoring committee⁵⁰ with community and business leaders, civil society organisations, departmental representatives and academics should be established to provide general oversight.

(3) Withdrawals and spending. Withdrawal rules, given that they determine how and when the funds may be released, are of critical importance to a Sovereign Wealth Fund. The commitment to integrate the drawdowns from the Fund into the national budget is a promising step. But as was discussed in the previous

47 PNG Government Department of Treasury, op. cit., 2012 Budget: The Establishment of a Sovereign Wealth Fund, 163-164.

48 International Working Group on Sovereign Wealth Funds, op. cit. See also Truman, op. cit., 121-137.

49 See Santiago Principles 4.1, 6 and 16, 10, 11 and 12, International Working Group on Sovereign Wealth Funds, Sovereign Wealth Funds, 7-8.

50 This suggestion is made by NRI in their submission on the SWF. See Johnson, op. cit., 19.

BOX 4.3: SOVEREIGN WEALTH FUNDS IN PNG - A TROUBLED HISTORY

Despite a promising start, governance problems plagued the Mineral Resources Stabilisation Fund (MRSF). Money was often channelled through agencies and state-owned corporations with little oversight or public accountability, and thus failing to reach priority areas.⁵¹ Other governance problems included a Board dominated by Government officials making highly politicised withdrawal decisions,⁵² fund expenditure separated from the budget process, and poor corporate governance standards.⁵³ Additionally, revenues were spent with little regard for the capacity of the domestic economy to absorb it, resulting in inflation and rising costs of living for the majority of the population who were not receiving benefits from enclave extractive industry projects.⁵⁴ This financial mismanagement, particularly bad in the 1990s, ultimately led to the demise of the fund. The removal of the 20 per cent withdrawal limit paved the way for larger withdrawals. In 1999 the entire remaining balance of the fund (almost K1 billion) was drained to pay for the Government's burgeoning public debts.⁵⁵

After the demise of the MRSF, the Government began channelling the revenues from windfall petroleum and mineral revenues into smaller Government Trust Accounts held by various agencies and departments within PNG's public sector. On the positive side, the Government's Medium Term Fiscal Strategy (2008-2012) imposes limits on spending.⁵⁶ Less encouragingly, the ad hoc governance approach has created the capacity for money to be misappropriated. There have repeatedly been allegations that funds deposited in the myriad of Trust Funds established by the government have been siphoned off into personal trust accounts.⁵⁷

In 2002, another consolidated fund, the PNG Sustainable Development Program (PNGSDP), was established by BHP Billiton with initial cash assets of \$US6.4 million (K26.8 million),⁵⁸ after its Ok Tedi mine in PNG's Western Province had caused devastating environmental damage to the surrounding river systems in the late 1990s. The company divested its 52 per cent

51 Aaron Batten, op. cit., 78 and 80.

52 Gould, op. cit., 6.

53 Department of Treasury and Bank of Papua New Guinea, Possible Creation of a Sovereign Wealth Fund: Discussion Paper (Joint Sovereign Wealth Fund Working Group, 16 April 2010), 4.

54 See Australian Parliament: Senate Foreign Affairs, Defence and Trade References Committee, op. cit., Economic challenges, 231 for discussion of balancing growth and inflation targets within the broader framework of ensuring financial stability.

55 See Eric Le Borgne and Paulo Medas, "Sovereign Wealth Funds in the Pacific Island Countries: Macro-Fiscal Linkages," IMF Working Paper, December 2007, 17.

56 See PNG Government Department of Treasury, op. cit., Budget: Expenditure and Financing, 65.

57 Barker, op. cit., Impact of the LNG Project and Managing the Wealth from the Project, 4-5.

58 PNG Sustainable Development Program Limited, Annual Report 2002, 4 http://www.pngsdp.com/images/documents/2002_annual_report.pdf

shareholding in the mine into two funds, a Long Term Fund and a Development Fund. Governance of the relatively small resources in PNGSDP has been better than that of previous Funds mentioned above.⁵⁹

The Long Term Fund has regularly published audited annual financial and operational reports exceeding the accepted level of corporate governance standards of similar extractive industry revenue management vehicles and trusts operated in PNG.⁶⁰ However, the success of development initiatives funded by the program has been mixed, and the PNGSDP has been criticised for continuing to invest, somewhat ironically, in projects with a high level of environmental impact, including the mining ventures of Newcrest and Oil Search, along with New Britain Palm Oil.⁶¹



Reading the candidate list and preparing to vote in the 2012 elections. Photo credit: Stephanie Lusby.

chapter, the need for fiscal restraint so as not to overheat the economy, alongside the public pressure for increased development expenditure on the back of the windfall, creates a difficult tension. Furthermore, the effectiveness of different levels of government in distributing and absorbing the spending is often limited.

(4) Multiple layers of accountable oversight. It is also commonly cited that the establishment of multiple lines of accountability is an effective way to fireproof against malfeasant political interference. For instance, an automatic parliamentary committee to oversee maintenance of fund balance and adherence to withdrawal rules will help. (Venezuela, Oman and Kuwait are countries with Natural Resource Funds which are vulnerable to improper management due to excessive control by the Parliamentary Executive).⁶²

Against the first criteria, the signs so far are encouraging. The PNG Government has committed to designing the funds in accordance with the Santiago Principles. Moreover, what has already been released about Fund Governance suggests that adhering to many of the strictures is at least being proposed.

Against the other criteria, the results are more mixed. As far as citizen engagement is concerned, the suggestion of an Appointments' Committee looks encouraging, although more detail would have to be provided on this matter than currently exists. The other thing to note is that, when it comes to the broader citizenry, effective engagement depends largely upon the nature of the media, the strength of the public

voice, and the level of the population's interest in national politics.

The restriction on using the Sovereign Wealth Fund to purchase government debt⁶³ is a very important development because it reduces the risk of a borrow-and-spend scenario about which economists warn. On paper the withdrawal rules also look promising, though the type of expenditure that will be permitted with the Stabilisation Funds has yet to be seen.

When it comes to assessing PNG's new Sovereign Wealth Fund in light of the criteria for accountable oversight, a much larger problem is reached. This is for the reason that sound design and firm rules alone cannot guarantee the safeguarding of fund assets. Rules may be overturned by future governments in response to public pressure to spend more, a change in circumstances, or simply the manipulation of those in public office. Somewhat paradoxically, the best performing funds are not necessarily those with the strictest rules and design safeguards. In the case of Norway, for example, the Parliament can, in theory, deplete the resources of the fund very easily as there is no minimum requirement for allocating oil revenues to the fund each year. While such flexibility might be a liability in another context, in Norway strong governance practices, adherence to the rule of law, and a large civil society provide adequate protection

59 For an outline of the Community Social Investment Program (CSIP) in the Western Province see PNG Sustainable Development Program Ltd, Western Province Program, <http://www.pngsdp.com/index.php/western-province-program>; For the National Program see PNG Sustainable Development Program Ltd, National Program, <http://www.pngsdp.com/index.php/national-program>

60 See Community and Social Investment Program information at <http://www.pngsdp.com/index.php/csip-publications>.

61 The PNGSDP has allegedly invested \$US890, 802 in the miner Newcrest, \$US14,022,541 in Oil Search, and \$US19,382,634 in New Britain Palm Oil. See Martyn Namorong, "PNG's unsustainable Development Company," Keith Jackson and Co: PNG Attitude, 6 September 2011, <http://asopa.typepad.com/asopa/people/2011/09/pngs-unsustainable-development-company.html>.

62 See Tsalik, op. cit., 17-52. Also see Christian Petersen and Nina Budina, Governance Framework of Oil Funds: The Case of Azerbaijan and Kazakhstan, Working Paper (Columbia Earth Institute, 2002), 5.

63 PNG Government Department of Treasury, op. cit., 2012 Budget: The Establishment of a Sovereign Wealth Fund, 155-156.

against the abuse of the Norwegian Oil Fund. In the case of Chad, on the other hand, despite a reasonable set of rules and less flexibility than Norway, the resource revenues were run-down quickly by the President primarily for military expenditure.

Evidence from other Sovereign Wealth Funds suggests that the most important ingredient for success is a robust democracy with an open and accountable political system.⁶⁴ In short, a strong political constituency demanding prudent and responsible management, and a government committed to broad-based economic development, rather than parochial vested interests are the best antidotes to poor decisions when it comes to Sovereign Wealth Funds.

The significance of this challenge for PNG is brought home by the realisation of how easily resource revenues can be used as a political football. In 2010, then Treasurer Peter O'Neill accused the PNGSDP (headed by Australian climate change expert and Ok Tedi mine director Ross Garnaut) of failing to deliver the improvements promised after BHP Billiton's huge environmental disaster.⁶⁵ In a public retort against his fellow parliamentarian, then-Opposition leader Sir Mekere Morauta accused O'Neill and others of plotting to sidestep the PNGSDP's governance framework in order to gain control of the funds: 'It would be a national crime if PNGSDP were to pass into the hands of politicians', said Morauta. 'This attempted takeover of PNGSDP smells to me of building war chests for elections'.⁶⁶ As Morauta's comments show, regardless of the rules, PNG's Sovereign Wealth Fund and control of the money within it, are likely to remain hotly-contested political issues.

In summary, as was suggested at the beginning of this Chapter, the establishment of a Sovereign Wealth Fund model will not, in and of itself, guarantee a positive outcome. Political reform in PNG is the most important insurance against official abuse of the Fund. Given the complex nature of politics in PNG, such reform is a long-term project involving the gradual integration of modern-state democratic traditions. This is more likely to take place across decades rather than in the space of a few short years.

SUMMARY FINDINGS

- Managing the volatile revenue streams generated from mineral and resource extraction projects is not new to the PNG Government. Nor is the management of the State's equity share in extractive industry projects through Sovereign Wealth Funds.
- The IPBC, a government institution central to PNG LNG state revenue management, has a poor track record of performing its mandated role in the national interest. While very recent legislative and operational reforms give reason to be more optimistic, the effectiveness of the reforms has yet to be tested, and their impact depends upon the

willingness of successive governments to maintain and adhere to them.

- The Australian Government believes that the establishment of a well-designed Sovereign Wealth Fund will enable 'effective and transparent governance' of the Project revenues and ensure that PNG LNG will benefit all Papua New Guineans. While a transparent and accountably-managed Sovereign Wealth Fund model will assist PNG to preserve the earnings from its natural investment in gas reserves over the longer term, Jubilee Australia firmly believes that a Sovereign Wealth Fund model is not enough.
- Evidence from cases around the world demonstrates that most misappropriation of natural resource revenue occurs long before the money reaches a Fund. Therefore, to be effective, transparency must also apply down the entire PNG LNG revenue chain, from the point at which money is paid by the Companies to government, to the points at which the revenue wealth is distributed and spent by national and sub-national authorities.
- For the above reasons, the inclusion for the first time in the 2012 Budget Papers of a recognition of the need for improved transparency, accountability and governance in the management of resource revenues, including a commitment to consider the implementation of EITI, should be seen as a positive and necessary step.
- The experience from the 1990s demonstrates that a political commitment to deposit all mineral rents into a specially-designed Sovereign Wealth Fund is not sufficient.
- Previous experience in PNG and elsewhere has demonstrated that rules alone cannot guarantee compliance, since they may be overturned by future governments in response to public pressure to spend more, a change in circumstances, or simply the manipulation of those in public office.
- Whilst the holding of revenues in the Sovereign Wealth Fund is helpful for limiting inflationary impacts, it does not solve the likely bottleneck of funds in public sector agencies and departments, as was the case with the MRSF.
- Political reform in PNG is the most important insurance against official abuse of the Sovereign Wealth Fund. Given the complex nature of politics in PNG, such reform is a long-term project involving the gradual integration of modern-state democratic traditions. This is more likely to take place across decades rather than in the space of a few short years.

64 Tsalik, *op. cit.*, 164. See also Monk and Dixon, *op. cit.*, 1.

65 See Ilya Gridneff, "BHP development fund in PNG defends role," Channel 9 News, 21 October 2009, <http://news.ninemsn.com.au/article.aspx?id=8110058> and Ilya Gridneff, "PNG govt turns blow torch on Garnaut and BHP," Keith Jackson and Co: PNG Attitude, 20 October 2010, http://asopa.typepad.com/asopa_people/2010/10/png-govt-turns-blowtorch-on-garnaut-bhp.html

66 Malum Nalu, Somare told not to destroy PNGSDP, 25 October 2010, <http://malumnalu.blogspot.co.uk/2010/10/somare-told-not-to-destroy-pngsdp.html>

5 THE VIEW FROM THE GROUND

About 10 to 15 per cent of the government and landowner revenues will be controlled, managed and spent at the local level. Furthermore, a large number of businesses have been generated, bringing money and opportunities into the Project impact areas as we speak. The injection of wealth has already begun to transform the local economies and the societies in the Project areas, especially in the Southern Highlands. This chapter will examine the story so far, in terms of the impact of PNG LNG-related revenues and business opportunities in the Project areas, especially the Hela Province. The institutions charged with managing the local-level revenues and the economic opportunities on the ground will also be discussed, as will the potential for Project-related conflict.

5.1 LOCAL LEVEL REVENUES

PNG LNG proponents often champion the positive benefit that the Project will have at the local level. The EIS, for example, makes the following predictions about benefits to the population in the Project's impact areas:

- 1) increased employment opportunities generated during the construction and operation phases and direct benefits stemming from payments to landowners;
- 2) business opportunities generated by the supply of inputs such as fuel, security and catering services, and from the expenditure of incomes earned from the Project and associated community and infrastructure projects;
- 3) improved transport infrastructure, which can increase accessibility of health and education services and improve the capacity for foreign trade.¹

ACIL Tasman makes two qualifications about these local impacts. First, it concedes that some of these benefits will go to the country's capital, instead of being felt at the local level. Second, and probably more important, the EIS goes on to say:

Despite the unique opportunity for governments at all levels to channel their share of the proceeds into improving infrastructure and services for the local communities, there is a risk that much of these resources will not reach the target beneficiaries [...] There is also a risk that the large sums of money flowing to individuals could aggravate social and health problems brought on by the consumption of alcohol and tobacco, imported foods, and could increase income inequalities.²

As was the case with the macro-economic impacts of the Project, authors of the ACIL Tasman Economic

Impact Study moderated their optimistic claims to a certain extent. But these qualifications have a tendency to get lost amid the general excitement about the positive benefits that will come.

KEY REVENUE SOURCES

Before we attempt to evaluate the current and future impacts of the Project, it is necessary to first sketch the key sources of local-level revenue and the roles of various institutions in delivering them. The four main sources are laid out in Table 3 below.

The following groups will be recipients of local-level revenues, grants and business opportunities.

- 1) The Landowners, who are represented by institutions known as Incorporated Landowner Groups (ILGs). Landowners, through the ILGs, will receive the bulk of two types of revenues: royalties, which are calculated as a percentage of the wellhead value of the gas; and dividends, the size of which will depend on the extent of share ownership that landowner groups possess (somewhere between three and seven per cent).
- 2) Sub-national governments, which include ... provincial governments (like the Government of the Southern Highlands Province) and local level governments (for example, Komo Local Government). These governments receive a small proportion of both the royalties and dividends, as well as development levies, which are calculated as a percentage of wellhead value.
- 3) Landowner-controlled businesses (LANCOs) set up by Landowners to take advantage of the business opportunities developing in their area. LANCOs bid for many of the different types of grants that are mandated under the gas agreement and also for contracting services offered directly by the Companies.

Aside from the ILGs, sub-national governments and the LANCOs, there are two other institutions that are important for this chapter. The first is the Mineral Resource Development Company (MRDC), which is a wholly state-owned corporation that manages funds for sub-national mineral and petroleum resources. It is a central stopover point for many of the major PNG LNG Landowner and sub-national government revenue streams. Also important is the Economic Corridor Implementation Agency, or ECIA (also known as the Expenditure Implementation Committee, or EIC), which, nominally at least, is supposed to have a role in the spending decisions of development levies and other Project-associated grants. Section 5.3 discusses the role of the ILGs, the LANCOs, the MRDC and the ECIA in more detail.

¹ As previously cited in Chapter 3, ACIL Tasman, op. cit., 25.

² Ibid., 26.

Table 3: Sub-national revenues: breakdown and management

| | LANDOWNER-DOMINATED REVENUE STREAMS | | | OTHER REVENUE STREAMS | | |
|-----------------------------------------------------------------|-----------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------|-------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------|
| | Royalties | CDOA Equity** | Kroton Equity | Development Levies | Other Grants | Project-Related Business Development |
| Amount expected | K 5.27 bill. | Estimated 2.78% of total equity | Estimated 4.22% of total equity | K 5.27 bill. | Infrastructure Development Grants: approx. K 1.2 bill. Business Development Grants: approx. K 0.1 bill. High Impact Infrastructure Grants: approx. K 0.4 bill. | K 0.4 billion (as of Nov 2011) |
| Distribution of revenues between sub-national recipients | 70% to Landowners 30% to Sub-National Governments | Free equity: 90% to Landowners, 10% to subnational governments. Paid equity: 100% to Landowners | 100% to landowners | Provincial and Local Level Governments | Landowner Corporations (LANCOS) | Landowner Corporations (LANCOS) |
| Distribution of revenues between Landowners | 72% to PDL areas, 28% to Pipeline and LNG Plant areas | Free equity: 72% to PDL areas, 28% to Pipeline and LNG Plant areas. Paid equity: 100% to PDL Landowners | 76% to PDL areas, 24% to Pipeline and LNG Plant areas | 72% PDL areas, 28% Pipeline and LNG Plant areas | - | - |
| Management/Spending Overseen By* | MRDC in combination with a Trustee (either relevant ILG or the Sub-National Government) | MRDC in combination with a Trustee (either relevant ILG or the Sub-National Government) | MRDC in combination with a Trustee (either relevant ILG or the Sub-National Government) | Expenditure Implementation Committee (EIC) | Expenditure Implementation Committee (EIC) | Project Proponents and by the Department of Commerce and Industry |

Source: Umbrella Benefit Sharing Agreement (UBSA)

*At least 60% of landowner royalties and equity payments must be held in what is known as Future Generation Funds (investment and future funds) which are overseen by the relevant corporate trustee (the relevant ILG) in combination with the MRDC. It is assumed that the remaining 40% will be disbursed as cash payments by the ILGs.

** CDOA equity is, according to the UBSA, the 2 per cent interest accruing to the Project Landowners from the State's 22.5% interest in the Project

5.2 LOCAL IMPACTS: THE STORY SO FAR

The following section draws on empirical evidence provided by two studies undertaken in 2011: first, the Oxfam Australia report, titled "Listening to the Impacts of the PNG LNG Project in Central Province, Papua New Guinea", published in November 2011;³ and second, the research published in May 2012 by Otago University, titled "The Community Good: Examining the Influence of the PNG LNG Project in the Hela Region of Papua New Guinea".⁴

ECONOMIC IMPACTS

The Southern Highlands region has already been



Photo credit: James McIlraith / University of Otago.

transformed by the economic injections that have attended the Project, principally:

- 1) Initial cash payouts. There were a number of initial cash payouts made around the time of the Final Investment Deadline, late 2009, and it is believed that these were mainly resettlement and land compensation payments for landowners who were most directly impacted by the Project.⁵

³ Oxfam Australia, Listening to the Impacts of the PNG LNG Project in Central Province, Papua New Guinea, November 2011.

⁴ McIlraith, op. cit.

⁵ See Jubilee Australia, op. cit., 41 for newspaper references to the increase in spending that immediately resulted and some social impacts.

2) Direct construction contracts. The second source of economic input into the Project area will be the Project-related construction and service contracts given directly by EHL. While the cash total of these contracts is unknown, as of mid-2011 over K390 million of contracts had been distributed.⁶ (These were not included in Table 3 because they are not technically Project revenues but rather business opportunities resulting from necessary Project development earmarked for local groups).

3) Business Development Grants (or BDGs): A K120 million fund was set up to facilitate greater participation of PNG nationals in business developments associated with the Project through construction activities or the provision of ancillary/supportive services such as catering, labour hire and security services.⁷ Although by now BDGs have largely been disbursed, they remain an important feature of this analysis given that they have been the focus of much of the community conflict related to the Project.

What has been the impact of these economic changes, especially in the Hela Province? On the one hand, many locals have been able to take advantage of the opportunities offered by the Project.

- Those fortunate enough to be able to be employed directly by the Project reported that their livelihoods have improved (although local workers have not always been happy about the level of pay).⁸
- Around 13 per cent of people interviewed by the Otago University Study were involved in new or existing business or investment opportunities connected to Project funds. Two thirds of these were in the Tari area (some of these were already existing businesses, some were new).⁹
- Some locals have turned to producing surplus agricultural goods and selling them to the LNG Project, others to buying, cooking and selling these surplus goods.¹⁰
- There is some evidence that saving and investment rates in Hela Province may be slowly increasing, although this observation stems from a very low baseline.¹¹

On the other hand, there is strong evidence that the opportunities are not being spread evenly across the population.

- A very high majority of interview respondents felt that the benefits of the Project were not being

shared equally. They perceived that benefits from the Project had been captured by some more than others, including more men than women, and the landowners who live inside the PDL area rather than those who do not.¹²

- Many of the local people believe that an educated and well-connected elite have been, as is the case in the national context, better able to capture the opportunities and financial benefits brought by the Project.¹³
- Inequalities have been exacerbated by the rising cost of food, since this may benefit those who have been able to capture revenues from the Project, while causing harm to those who have not been so lucky.¹⁴

SOCIAL IMPACTS

On a broader scale, societal impacts of the Project so far include:

- The distortion of marriage and gender relations. One of the ways this is happening is through the rising cost of the 'bride price', which makes it more difficult for many young men to marry, and increases social frustrations as a result.¹⁵
- The mixed impact of an increased amount of cash in the economy. Some claim that there have been positive impacts on family relations with improvements to livelihood; but others point to an increase in household disputes (especially between husbands and wives) relating to spending.¹⁶
- An increase in destructive social practices. The influx of temporary workers and money has been linked to the exacerbation of existing social problems, including prostitution, gambling, drug abuse and, perhaps most rampant of all, alcohol abuse.¹⁷
- Internal migration pressures. The increase in work opportunities and the improved transportation infrastructure has spurred a wave of internal migration into the Hela Province from other areas of PNG, especially the centres of Komo, Hides and Tari. This migration has increased the pressure on basic social services.¹⁸

¹² Ibid., 42.

¹³ Ibid., 49.

¹⁴ The Otago University's 'Community Good' report states: 'Surveys undertaken of stores in Tari and markets around the Hela Region gauged price increases in relation to a basket of everyday goods between June 2010 and June 2011. The price increase averaged across stores in Tari was 38 percent, while the price increase averaged across markets in the Hela Region was 28 percent. The most significant increases were in basic items. For example, the greatest rise in the basket of goods was Kaukau (sweet potato) from the local market. The price of one large Kaukau has risen from around 50 Toea to around three kina in Tari, an increase of 350 percent (1 Kina = 100 Toea). For the same item, Komo has seen an increase of around 220 percent. Other examples include chickens, which have gone up by 35 percent, the price of a single betel nut by 70 percent as well as other costs such as public motor vehicle (PMV) fares. The price of PMV fares departing from Tari have gone up by an average of 36 percent between June 2010 and June 2011. Ibid., 42.

¹⁵ Ibid., 47.

¹⁶ Ibid., 47.

¹⁷ Ibid., 51-52.

¹⁸ Ibid., 46.

⁶ PNG LNG Consortium, PNG LNG Quarterly Environmental and Social Report, 2nd Quarter 2011, http://www.pnglng.com/media/pdfs/quarterly_reports/Q2_2011_ES_Report_FINAL_26-08-2011_FULL.pdf 10.

⁷ PNG LNG, Papua New Guinea LNG Project: National Content Plan, Revision G, July 2009, www.pnglng.com/media/pdfs/commitment/nc_plan_rev_g.pdf, 10-43. See in particular Chapters 3 to 6, which outline plans and strategies for workforce and supplier development. See Peter Graham, 'The PNG LNG Project: Business Development Update', PNG LNG Investment Conference, Sydney, Australia, 7 December 2010, and the comments of Peter Graham, as Managing Director, PNG LNG Project in Jemima Garrett, 'PNG LNG boss speaks out on jobs and landowner businesses,' Pacific Beat (Radio Australia), 13 June 2011, <http://www.radioaustralia.net.au/pacbeat/stories/201106/s3242180.htm>.

⁸ See Eoin Blackwell, 'Workers on Strike at PNG LNG Site,' Ninemsn News, 25 August 2011, <http://news.ninemsn.com.au/world/8290236/workers-on-strike-at-png-lng-site>.

⁹ McIlraith, op. cit., 42.

¹⁰ Ibid., 42.

¹¹ Ibid., 42.

- Environmental incidents. The most significant environmental incident so far was the fatal mudslide at the Tumbi quarry in January 2012, which led to the death of at least 26 and as many as 62 people, mainly migrant workers, and the destruction of 42 homes. Tumbi was a pre-existing quarry that had been used by EHL until mid-2011.¹⁹ This is the most serious loss of life associated with the Project thus far. The extent of EHL's responsibility for the landslide remains an open question at this stage.²⁰ Nervous traditional Landowners, worried that they might become victims of a future landslide, immediately called for the company to resettle them on new land away from the site.²¹



The Tumbi Landslide January 2012.
Photo credit: LNGWatchPNG.blogspot.com.

Tensions and violence relating to the Project have also been reported. They include three variations:

- 1) tensions related to land disputes in PDL 152, which have spilled over into violence resulting in deaths on at least two occasions;
- 2) violence over disputes regarding employment and pay, which has resulted in strikes and in attacks on the Project's expatriate workforce in the Hela Province.
- 3) repeated troubles in late 2011 and early 2012 regarding dissatisfaction over the allocation of the Business Development Grants (see Box 5.1).

The implications of this trouble surrounding the BDG scheme, as well as the other two incidents mentioned above, are discussed more fully in Section 5.4.

¹⁹ According to Catherine Wilson, the 62 figure for the landslide victims was from the PNG Red Cross: "Double Anguish for Tumbi Landslide Survivors," PNGExposed Blog, 24 March 2012, <http://pngexposed.wordpress.com/tag/exxon-mobil/>.

²⁰ EHL said that it is unclear what caused the landslide, and the PNG Government has claimed that it was not connected to the quarry. See Rebekeh Kebede, "Papua New Guinea Mountain Disaster Asks Questions of Exxon," The Guardian, 6 March 2012, <http://www.guardian.co.uk/business/feedarticle/10128703>.

²¹ "Exxon Mobil landowners want resettlement before another disaster occurs," PNGExposed Blog, 30 January 2012, <http://pngexposed.wordpress.com/2012/01/>.

BOX 5.1: THE BUSINESS DEVELOPMENT GRANTS CONTROVERSY

Controversy at the end of 2011 and beginning of 2012, over the Business Development Grants scheme, has been a major flashpoint for the PNG LNG Project. The Department of Commerce and Industry, which administered the BDG scheme,²² was supposed to disburse grants to PIA LANCOs for business development. But allegations were made by the then-National Planning Secretary Joseph Lelang of political interference in the distribution of BDGs. He claimed that he was pressured to spend DNPM monies, including BDGs, for political purposes such as distributing largesse to Hela politicians for political reasons.²³ It has also been claimed funds were distributed to companies based in Port Moresby.²⁴ Further allegations have been made confidentially to Jubilee Australia that some of the business development initiatives are not viable beyond the construction phase of the Project, were used for non-business purposes, or were distributed as a per capita distribution to ILG members, thus losing the economies of scale in business investment.²⁵

In January 2011, the National Court issued orders to freeze temporarily all LNG associated payments including BDGs 'to prevent further fraud and misappropriation'.²⁶ The Acting Prime Minister ordered a departmental review, and in March 2011 the then-Deputy Prime Minister Sam Abal indicated that a number of government departments involved in administering BDG funds would be 'cut off from having a direct involvement with landowner payments'.²⁷ Nevertheless, by May 2011, 80 per cent of the grants had been attributed.²⁸

The resulting misdistribution of BDGs has triggered an outbreak of Landowner tension and has led, unsurprisingly, to instances of violence.²⁹ In January of this year, over 1000

²² The BDGs were also supposed to be subject to additional approval by EIC - as noted in Clause 13.2 and Clause 14 of the UBISA. However, these requirements were abandoned.

²³ "Planning Secretary details government misuse of K98 million to buy support," PNGExposed Blog, 2 February 2011, <http://pngexposed.wordpress.com/2011/02/02/planning-secretary-details-government-misuse-of-k98-million-to-buy-support/>.

²⁴ Mohammad Bashir and Andrew Alphonse, "LNG work stopped," Post Courier, 19 January 2011, <http://www.postcourier.com.pg/20110119/news01.htm>.

²⁵ Field Communication, Port Moresby, June 2011.

²⁶ Samuel Raitano, "National Court stops all LNG payments," The National, 21 January 2011, <http://malumalu.blogspot.co.uk/2011/01/national-court-stops-all-lng-payments.html>. Justice Ambeng Kandakasi said there were many cases brought to court that "smelt of fraud."

²⁷ Jonathan Tannos, "Total revamp of payment process," Post Courier, 1 March 2011, <http://www.postcourier.com.pg/20110301/news02.htm>.

²⁸ McIlraith, op. cit., 40.

²⁹ In Gobe Petroleum Development Licence (PDL 3 and 4), see "Locals harass staff" The National, 9 May 2011, <http://www.thenational.com.pg/?q=node/19186>; Tannos, op. cit.; "Papua New Guinea government has no directions for long term landowner issues," Papua New Guinea Blogs, 25 February 2011, <http://www.pngblogs.com/2011/02/papua-new-guinea-government-has-no.html>; Nicholas Issacs "Gas owners fight over K115mil" The National, 23 February 2011; Jemima

people shut down work of the proposed Hides Conditioning Plant, via a peaceful sit-in. The protesting clans participating in the sit-in said they were dissatisfied with the disbursement of BDGs.³⁰ In February 2012, Landowners from the Hela region led a protest in Port Moresby demanding payment of the grants, which resulted in three officers of the Department of Petroleum and Energy being taken hostage.³¹

5.3 LOCAL REVENUE MANAGEMENT AND DISTRIBUTION IN THE PRODUCTION PHASE

With the commencement of the production phase in 2014 or 2015, the revenue environment will change substantially, when new income relating to the UBSA and LBBSA start to 'flow'. The production phase revenues will be of three types.

- 1) Revenues to sub-national governments. As was shown in Table 3, a substantial amount of the Project-related income entering the local communities will derive from royalties, dividends and development levies. All of the Development Levies will be going to provincial or local governments. The sub-national governments will also receive small amounts of the royalties (30 per cent) and the dividend equity (around 10 per cent).
- 2) Cash payments and investments for Landowners. 40 per cent of the local level revenues will be distributed as cash payments. Most of the cash disbursements by the ILGs are expected to be spent immediately. There is strong circumstantial evidence that this is what happened to the upfront payments made to Landowners immediately after the signing of the PNG LNG deal.³² Moreover, it is consistent with research about cash payments in PNG on other previous occasions.³³ The remaining 60 per cent of Landowner-controlled revenues is held for each Landowner group by the MRDC in two funds of equal value: a Community Investment Fund and a Future Generation Fund (the purpose of which is to provide a source of ongoing financial support to communities after the Project has finished).
- 3) Business Grants. Aside from the BDGs, there are two types of infrastructure grants that are being made available to LANCOS: the K1.2 billion worth of

Garrett, "Landowners threaten to shut down PNG LNG Project," ABC Radio Australia, 26 May 2011; Mohammed Bashir, "OSL posts K483m profit," Post Courier, 12 May 2011; Patrick Talu, "Unsolved issues forced people to act, say leaders," The National, 26 January 2011; Samuel Raitano, "Police minister asks LNG Project landowners to respect rule of law," The National, 5 January 2011.

30 Mohammad Bashir and Andrew Alphonse, "LNG work stopped," Post Courier, 19 January 2011.

31 Junior Ukaha, "Three 'rescued' in LNG hostage drama," The National, 25 February 2011. See also Anonymous, "Papua New Guinea government has no directions for long term landowner issues," Papua New Guinea Blogs, 25 February 2011, <http://www.pngblogs.com/2011/02/papua-new-guinea-government-has-no-htm/>.

32 Andrew Alphonse, "Landowners Go on a Spending Spree," The National, 10 December 2009, <http://www.thenational.com.pg/?q=node/3837>.

33 The Social Impact Assessment appears to claim at one point that only 8% of Project-affected people invest their cash disbursements, see Goldman, op. cit., Social Impact Assessment, 3-92.

Infrastructure Development Grants (IDGs), mainly in the Project area which are yet to come online; and some grants for High Impact Infrastructure.

INSTITUTIONAL WEAKNESSES AND AREAS OF CONCERN

There are four main institutions that are relevant in the delivery of the local-level revenues: the Mineral Resources Development Corporation (MRDC); Incorporated Landowner Groups (ILGs); the Economic Corridor Implementation Agency, or ECIA (also known as the Expenditure Implementation Committee, or EIC); and, Landowner Companies (LANCOs). Each will be discussed in turn.

THE MRDC

The MRDC was set up to work with Landowner groups to manage revenues coming from mining and other extractive industry projects in PNG. The MRDC already administers a number of subsidiary trustee companies for other resource projects, including Kutubu, Ok Tedi, Star Mountain, Gobe and Moran.³⁴ These trustee companies are made up of ILG and sub-national government representatives who are members/ shareholders. The institution has a key role in managing the PNG LNG revenues (royalties, dividends, and likely the development levies) of Landowners, and may even do the same for sub-national governments.

The MRDC has many of the structures of an average company, including a constitution with Articles of Association and a governing Board.³⁵ Currently the MRDC Board has eight Director-members: three are independent directors and five are compulsory appointments from Statutory Offices. Simon Tosali, PNG's current Secretary of Treasury, is the chairman of the MRDC Board. The Managing Director's post is filled by Augustine Mano, who has a historical association with the petroleum industry in PNG. The remainder of the Board of Directors is made up of a selection of senior government officials and PNG business identities.³⁶

The MRDC is expected to provide the technical corporate management assistance and advice to ILGs and other beneficiaries, who are themselves supposed to dictate disbursement of Project income. It claims to have an 'arm's length' position with respect to the funds that it helps to manage. For example, when creditors of particular ILGs or their executive members have sought the MRDC's help to settle debts of ILGs, the MRDC has indicated that it can only disburse trust funds to ILGs themselves, not to other groups.³⁷

A history of the MRDC reveals real concerns about its capacity and suitability as the key agency involved in local revenue management. A 2009 Auditor General's investigation into its corporate governance found a

34 See Mineral Resources Development Company, MRDC and Subsidiary Companies, <http://www.mrdc.com.pg/investments/index.htm>.

35 Mineral Resources Development Company, Divisions, <http://www.mrdc.com.pg/about/divisions.htm#>.

36 Mineral Resources Development Company, Board of Directors, <http://www.mrdc.com.pg/about/board.htm>.

37 See Mineral Resources Development Company, Gobe Petroleum Project Area Incorporated Land Group (ILG) Creditors (Public Notice), 12 May 2010, <http://www.mrdc.com.pg/media/NOTICE.htm>.

number of disturbing facts: the MRDC did not lodge tax returns for the years 2005, 2006 and 2007, as well as suffering from many accounting procedure shortcomings. The institution has also been reported to have taken investment decisions without independent valuations or full Board deliberation, and acquired assets on behalf of certain landowner companies without Board approval, an independent valuation, or advice about the tax consequences of foreign investment.³⁸ Other allegations against MRDC include:

- distributing benefits to newly-created ILGs without the knowledge or consent of current ILG members of landowner companies;³⁹
- permitting trustee company Board meetings to be held in Cairns, Brisbane and the Gold Coast;⁴⁰
- attempting to prevent the investigation by the Ombudsman's Commission into the termination payments for MRDC's former Managing Director and CEO John Francis Kaupa.⁴¹

Given these problems, it is unsurprising that during the negotiation process, a number of Landowner groups have claimed that, in the absence of significant reform, continued conflicts of interest, misapplication of funds and general poor trusteeship should be expected. Some have argued that the institution should be forced by the National Government to implement governance changes including: greater representation of landowner communities on the Board; full publication of MRDC audited accounts and the annual reports of all trustee companies, to enable identification of discrete revenue streams; and adoption of professional fund managers with strong international reputations and profiles in investment.⁴² Some have urged that provision also be made for landowner trustee companies to opt out of MRDC fund management and trusteeship if they are able to meet their own minimum reporting and governance standards.⁴³

38 PNG Auditor General's Office. 2009 Auditor General's Report, Part IV, Public Bodies and their subsidiaries, Government Owned Companies, National Government Shareholdings in Other Companies, 2009, <http://www.ago.gov.pg/docs/reports/PART%20IV%202009%20Section%203.pdf>, 214 and 218-220. For more information about some of these incidents, see Mohammad Bashir, "MRDC in Troubled Airline," Post Courier, 9 May 2011, <http://www.postcourier.com.pg/20110509/business01.htm>; Augustine Mano, Press Release: Response to allegations against MRDC, 5 May 2011, <http://www.mrdc.com.pg/media/ResponseTA.htm>.

39 Goldman, op. cit., Social Impact Assessment, 3-13. See also Mineral Resources Development Company Ltd v Sisimolu [2010] PGSC 50; SC1090 (15 December 2010) which relates to an allegation of MRDC paying benefits to persons who represented that they were members of Wolutou ILG (Gobe).

40 See Moi Avei, Minister for Petroleum and Energy, "Government Initiatives in the Petroleum Sector," PNG Mining and Petroleum Investment Conference Sydney, 3 December 2002, 9.

41 See Mineral Resources Development Company Ltd v Ombudsman's Commission of Papua New Guinea [2008] PGSC 17; SC931 (20 August 2008). Since these allegations were made, new managing director Augustine Mano released audited annual reports for each MRDC subsidiary landowner company, going back to 2008. Mohammed Bashir, "MRDC responds to LO threats," Post Courier, 29 April 2011, <http://www.postcourier.com.pg/20110429/business01.htm>. It has been claimed that a special investigation recently ordered by new Prime Minister Peter O'Neill will look into many of these concerns. See Mohammed Bashir, "PM orders probe into MRDC," Papua New Guinea Mine Watch, 28 September 2011, <http://ramumine.wordpress.com/2011/09/28/pm-orders-probe-into-mrdc/>.

42 Many of these reforms were suggested at the UBSA by landowner groups: see clause 9.1(i) to (vi) UBSA.

43 An example is the proposal of the Hides Sustainable Trust Fund outlined in the PNG LNG Gas Project PDL 1 (Hides Position Paper) (May 2009).

INCORPORATED LANDOWNER GROUPS (ILGS)

ILGs manage and disburse Landowner royalties and dividends among the Landowner groups and, in partnership with the MRDC, control the related investment decisions. ILGs receive royalties and dividends from the MRDC trustee companies and distribute the benefits to their individual clan, sub-clan, tribe or village members. Under PNG law, traditional customary landowner groups, whether demarcated by language, clan, sub-clans, tribes, villages or families, can register for incorporation, a process which requires that they establish some of the hallmarks of modern corporations.⁴⁴ ILGs first came to prominence during the Chevron Niugini Limited (CNGL) Kutubu oil project in 1992, having been cemented into legislation in 1991 (Forestry Act) and again in 1998 (Oil and Gas Act). By 2004, over 10,000 ILGs had been incorporated, and the Department of Land and Physical Planning continues to process applications for registration on a daily basis.⁴⁵

The premise of ILGs was supposedly to encourage the use of modern corporate structures flexible and malleable enough to absorb and reflect customary laws and relations, and to enable participation in modern commercial enterprise.⁴⁶ However, as detailed in Box 5.2, ILGs have been plagued by problems from the outset and now stand accused of being primarily tools for benefit distribution.



Scrutineers, police, election officials and campaign managers trying to solve allegations of ballot box tampering, 2012 elections. Photo credit: Stephanie Lusby.

44 These include having a constitution that sets out qualifications for membership, composition and appointment of a controlling or executive body, mechanisms to authorise group actions and identification of dispute settlement authority.

45 See Fingleton, op. cit., "A Legal Regime for Issuing Group Titles to Customary Land," 23-31.

46 For a critique of this concept see James Weiner and Katie Glaskin, "Customary Land Tenure and Registration" in Customary Land Tenure and Registration, eds. Weiner and Glaskin, op. cit., 7.

BOX 5.2: HISTORY AND PROBLEMS WITH ILGS

A number of concerns have been raised about ILG functioning. First, the ILG system is accused of suffering from serious governance deficiencies. For example, it lacks: a systematic process of electronic recording of ILGs; specific oversight mechanisms that prevent operations contrary to their constitution; availability of competent dispute management authorities; sufficient powers for government agencies to deal with dysfunctional ILGs; and, training and development in ILG management.⁴⁷

Second, the existing rules, whereby benefit distribution is dependent on the total number of ILGs in the particular licence area, have encouraged a tendency for ILGs to splinter. This splintering produces disruptive impacts on inter-clan social relations and reduces economies of scale, which in effect, harms investment choice and opportunities.⁴⁸

Third, the misappropriation of benefits has been linked to a lack of sound investment decisions.⁴⁹ Resources are rarely reinvested in business ventures that could help the revenues generate sustainable development. The lack of proper investment guidelines is related to the poor corporate governance of ILGs and a general lack of interest in their operation by the Government and the companies that created them.⁵⁰

Fourth, and most importantly, ILGs have been accused of participating in unlawful and unfair benefit sharing, facilitated by the absence of transparency and accountability. Corruption and bribery are also evident in revenue management by some ILGs. There are cases where some members of ILGs—particularly women—are denied access to cash benefits by chairmen and executive members of ILGs who hold bank passbooks. Chairmen and executive members have ample opportunity to improperly apply or misappropriate funds, and from anecdotal evidence these misappropriated funds enable some ILG executives to become part of the PNG urban elite.⁵¹

The myriad of problems is perhaps not surprising, given the circumstances surrounding their creation and subsequent evolution. The

original purpose of ILGs was to facilitate the ability of clans or tribes to enter ‘dealings and agreements’ pertaining to their land, without undermining communality of land ownership.⁵² But the use of ILGs to assign, manage and distribute Project benefits has been geared towards the Project management requirements of the extractive resources industry. Numerous publications, including EHL’s own Social Impact Assessment, as well as a 2008 AusAID publication on the topic, and other academic work, allege that that Southern Highlands Landowners merely see ILGs as benefit distribution mechanisms.⁵³ Today, the reality is that money coming through ILGs helps ‘buy’ landowner support and their consent not to disrupt extractive projects on the land.⁵⁴

PNG LNG’s own Social Impact Analysis by Laurence Goldman, found approximately 60 per cent of Landowner households dissatisfied with their ILG.⁵⁵ This negative attitude of Landowners, identified in 2005, was also found in the two main 2011 studies of PNG LNG-affected communities. Both the Otago University Study in the Southern Highlands and the Oxfam Listening Project in PDL 152 reported widespread dissatisfaction with ILGs.⁵⁶

ILG identification for the Project has begun, although indications are that there is still some way to go in the process. The PNG Lands Department is undertaking the process, with EHL having stated that it will not be taking part.⁵⁷ There are a number of different mechanisms for defining membership of ILGs, either along clan lines, or via zones. Likewise, there are a number of different ways in which benefits can be distributed among ILGs, for example, equally among the total number of ILGs (e.g. in Kutubu), or unequally according to the size of membership or size of land (e.g. in Moran). Indications are that PNG LNG will use the ‘stock clan’ method as opposed to the ‘zone’ method. This is despite the fact that EHL’s Social Impact Analysis warned against the use of this method, given it is particularly unsuited to Huli social relationships.⁵⁸

The AusAID Book Chapter on ILGs referred to above includes the following warning:

[...] if groups are incorporated only for the purpose of receiving payments they face a strong incentive to engage in non-productive

47 Goldman, Social Impact Assessment, Chapter 3, 5-6. This presents obvious difficulty for identifying beneficiaries in a particular licence area and distributing benefits to the correct ILGs.

48 Even in the Project area there has been an exponential proliferation of ILGs from Juha to Kikori where there are upwards of 700-800 ILGs. See Goldman, Social Impact Assessment, Chapter 3, 4.

49 Goldman, Social Impact Assessment, Chapter 3, 6.

50 See Lawrence Goldman, “Incorporating Huli: Lessons from the Hides License Area” in Customary Land Tenure and Registration, eds. Weiner and Glaskin, op. cit., p. 100. See Fingleton, op. cit., “A Legal Regime for Issuing Group Titles to Customary Land,” 32, for PNG Department of Petroleum and Energy findings on ILGs in the petroleum sector.

51 Goldman, op. cit., “Incorporating Huli,” 101 and 113. S.K. Koyama, “Reducing Agency Problems in Incorporated Land Groups,” Pacific Economic Bulletin 19, no. 1 (2004), 20-31; M. Taylor, and K. Whimp, Report on Land Issues and Hydrocarbon Framework Study, Asian Development Bank for Department of Mining and Petroleum (Port Moresby, 1997).

52 For a fuller history see Fingleton, op. cit., “A Legal Regime for Issuing Group Titles to Customary Land,” 7.

53 Goldman, op. cit., Social Impact Assessment, Chapter 3, 8; [...] Tony Power, “Incorporated Landowner Groups in Papua New Guinea,” in Making Land Work: Volume Two Case Studies (Commonwealth of Australia, 2008) 10-12; James Weiner, “The Foi Incorporated Land Group: Group Definition and Collective Action in the Kutubu Oil Project Area, Papua New Guinea,” in Customary Land Tenure and Registration, eds. Weiner and Glaskin, op. cit., 121.

54 Fingleton, op. cit., “A Legal Regime for Issuing Group Titles to Customary Land,” 27-28; Dan Jorgensen, op. cit., “Clan-Finding,” 66; Weiner and Glaskin, op. cit., “Customary Land Tenure and Registration,” 5.

55 See, for example, Goldman, op. cit., “Incorporating Huli,” 101.

56 McIlraith, op. cit., 37 and Oxfam listening project 17-18.

57 McIlraith, op. cit., 37.

58 Ibid, 37.

rent-seeking behaviour, as demonstrated at Kutubu.⁵⁹

This is precisely what is again happening with the PNG LNG Project. ILGs are being set up just to handle the revenues, making them vulnerable to the very risks that the AusAID publication and other research analysts warn against.

ILGs, once established and receiving revenues, will have a great deal of autonomy in deciding how the money is spent—not just the cash but also the 60% of local-level revenues held in the Trust Funds. Beyond the non-negotiables set out in the legislation, each nominated trustee company has wide discretion about how to manage the funds. There are no legislative prescriptions on how the principal income is to be spent, except that the Community Investment Funds' dividends and investment must be spent on general health, welfare, education and wellbeing of PIA Landowners, or community projects.

A number of analysts have proposed the abandonment of financial disbursements to ILGs in favour of on-site disbursement through clan agents for the 40 per cent of Landowner revenues that are disbursed as cash.⁶⁰ This strategy, quite common in the PNG mining sector, could be a better way to ensure that the cash is distributed more equitably in the community. It is, however, unlikely to be introduced at this stage. Moreover, even if it were, ILGs would still control the 60 per cent of the funds that are held in the Savings and Infrastructure Funds; thus the problems identified above would remain, with respect to the majority of the revenues.

THE EIC

The Economic Corridor Implementation Agency, or ECIA (also known as the Expenditure Implementation Committee, or EIC) was set up to assist sub-national governments in managing and planning development levy and other Project benefit expenditures, and to avoid coordination and logistical problems that had been encountered with this process in the past.⁶¹ The EIC comes under the Department of National Planning and Monitoring (DNPM), the agency which controls most of the Government's development budget and its long-term planning. It is believed that provincial and local level governments should technically be required to apply to the EIC before spending the revenues from development levies (K5.3 billion).⁶² An example of a sub-national government project that is taking place

as a consequence of the Project is the development of the Tari airport, an undertaking that was initiated by the Southern Highlands Provincial Government.

A number of the other grants (business and infrastructure grants) are also supposed to be administered through the EIC, although as was made clear in Section 5.2, the BDGs were not.⁶³

A cloud of uncertainty still hovers over the future role of the EIC in PNG LNG revenue management. As of 2008, although the EIC was operational and receiving project submissions, it had yet to process or disburse any submissions from sub-national governments and in fact had yet to perform any of the functions for which it was mandated. This meant that, at least as of that time, there had effectively been no improvement to the process of transferring revenue entitlements to the provinces, or to processes associated with the development of plans and the approval and implementation of projects. Thus, sub-national governments could still access revenue from DPE, DNPM and MRDC accounts without any effective oversight.⁶⁴ EHL's own Social Impact Analysis found numerous problems besetting the committee and concluded that "it is questionable whether the EIC will acquire the capacity and the authority to perform its mandate in time to influence the outcome of the remaining oil and future LNG revenue".⁶⁵

In 2011, the integrity of the DNPM came under serious attack during the rather public feuding between the sacked Planning Secretary, Joseph Lelang, and his political bosses. Lelang was suspended in February 2011 after being accused of involvement in the improper distribution of approximately K98,000 of the Department's money. PNG's Post Courier newspaper described Lelang as a 'sacrificial lamb' and cited a memo written by Lelang to his Minister Paul Tielsten. The original Lelang memo itself had already been leaked online on one of the prominent PNG anti-corruption blogs.⁶⁶ In it, he alleged that he had been instructed by then-Finance Minister Peter O'Neill to disburse most of the DNPM's funds to shore up support for O'Neill's leadership bid among MPs. He also alleged that then-State Enterprises Minister Arthur Somare instructed him to release some of the funds to supporters in the Hela Province. The Post Courier linked the source of the missing funds to the controversial Business Development Grants (Box 5.1).⁶⁷ In an affidavit submitted by Lelang's legal team before the National Court in May 2011, Lelang claimed that in the three months of his suspension, 90 per cent of

63 The only disbursement of IDGs which has been made, to the knowledge of the authors, was also not done in this way. I. Nicholas, "K16m paid on site at Hides 4," *The National*, 14 February 2011.

64 Goldman, op. cit., Social Impact Assessment, 3-350 - 3-351, http://www.pnglnc.com/media/pdfs/environment/eis_appendix26.pdf.

65 Ibid., 3-351.

66 "Planning Secretary details government misuse of K98 million to buy support," PNGexposed Blog, 2 February 2011 <http://pngexposed.wordpress.com/2011/02/02/planning-secretary-details-government-misuse-of-k98-million-to-buy-support/>. Commentary on the scenario on the same blog suggests that Lelang was sacked in a fit of pique by then-PM Michael Somare not for the act itself, which was common in the PNG Government, but because he had wanted to gain access to the disbursed funds himself. "The strange case of Joseph Lelang needs some explanation," Papua New Guinea Blogs, 31 May 2011, <http://www.pngblogs.com/2011/05/strange-case-of-joseph-lelang-needs.html>.

67 "Tamura, Lelang Suspended", Post Courier, 10 February 2011, <http://www.postcourier.com.pg/20110210/news01.htm>

59 Power, op. cit., 15.

60 G.E. Clapp, "Agents: The Case For and Against," (Port Moresby: BP PNG Pty Ltd, 1998) (unpublished memorandum) cited by Colin Filer, op. cit., "Local Custom," 153.

61 The then - Minister Avei stated that there would be an improvement in Project development and management by EIC overseeing distribution of funds for MOA projects. See Avei, op. cit., , 10.

62 The UBSA seems to mandate such a role for it with respect to PNG LNG revenues. See Section 13.1 (c), (d) and (e).

the K2.1 billion that the DNPM received direct from the Government had gone missing; this amounts to about half the DNPM's budget, the other half coming from aid donors.⁶⁸ Lelang's allegations involving O'Neill are of particular concern, given he has since assumed the role of Prime Minister; but more generally, they show how easily PNG's development budget can be waylaid when those at the top of the political tree decide that it is in their interest to do so.

LANCOS

Landowner Companies (LANCOs) represent groups of Landowners and act as vehicles to enable local businesses to compete for government grants and project-related tenders. LANCOs were incorporated under the PNG Companies Act to give expression to local business aspirations to become involved in extractive industry activity. PNG LNG LANCOs in the PIA can competitively tender to the Department of Commerce and Industry for the business development grants.⁶⁹ It is not known whether LANCOs will be eligible to bid for any of the projects that result from the increased revenue flows to the provincial and local-level governments. Nonetheless, they have been the main recipients of EHL contracts tendered out during the construction phases of the Project, and as a result, they control and manage much of the employment activity that has arisen as a result of the Project. This fact alone makes them of critical importance.

LANCOs, however, face an array of challenges. Like the ILGs, rather than having broad shareholder representation, LANCOs are controlled at the top by a few influential individuals. Not surprisingly, there is also community mistrust of LANCOs. In the case of PNG LNG, an independent body has raised specific concerns about the legitimacy of LANCOs that were formed before the ILG formation took place.⁷⁰ The Otago University research found that the main umbrella LANCO in Hela region, the Hides Gas Development Corporation (HGDC), is in need of reform, having faced difficulties managing the challenges of distributing Project contracts to local businesses and smaller LANCOs that are dependent upon it.⁷¹

IS REFORM POSSIBLE?

What conclusions can we draw about the institutions that are to deliver the revenues to local level groups? First, serious problems to do with governance and historical proneness to misuse attend three of the four institutions examined (the MRDC, ILGs and the EIC/DNPM). This only builds on the concerns raised in the previous chapter about institutional weaknesses at the national level. Uncertainty over whether the EIC will have a role in overseeing the spending of the development levies and the distribution of other Project-related grants, means ongoing doubt that these funds will be well-directed. While problematic,

the LANCOs appear slightly more efficacious than the MRDC, ILGs and the EIC/DNPM.

Although we do not want to downplay the problems with the MRDC, there appears to be some possibility for reform, provided that there exists political will to do so. It would seem relatively straightforward for the Government to enforce stronger reporting requirements on the MRDC, mainly relating to transparency. If transparency requirements for the MRDC were improved, and enforcement for breaches was applied, the risk of funds not reaching their intended targets would be reduced. Yet the political and institutional hurdles to achieving this are significant.

Transparency for the MRDC, and also for the EIC, could also be improved by an extension of EITI implementation downward to the local level. Such a move would require reconciliation of revenue amounts in the MRDC-managed trust companies and within sub-national government accounts with the amounts disbursed to them. Although EITI guidelines and policies themselves are silent on implementing EITI disclosures beyond the national government level, the issue has generated considerable discussion.⁷² Ghana, for example, is working towards fully implementing EITI at the Sub-National level with some traditional chiefs/authorities already publishing audited accounts.⁷³ Implementation could provide an efficient and effective way to track disbursement of levies and royalties, as well as discourage misappropriation of revenues while in trust accounts awaiting disbursement

The most intractable problems seem to be with the Landowner institutions, especially in regard to the future of the all-important ILGs. The difficulties there seem more entrenched, given the institutions themselves have greater autonomy, making the



Runway extension work next to Tari Airport, 2011. Photo credit: James McIlraith/University of Otago.

implementation of regulatory measures more difficult. Furthermore, they are compromised by the historical association with company 'buy-offs' for the right to resource exploitation. And since weaknesses in the system have already resulted in the creation of different groups, it seems that in some ways improving regulation of ILGs could now be a question of shutting the gate after the horse has bolted.

68 See more generally[,] Simon Erero, "Report: K1.2 billion missing, MPs named," Post Courier, 4 July 2011, <http://www.postcourier.com.pg/20110704/news02.htm>.

69 UBSA Clause 6.1(e) 72% of grants available for PDL area LANCOs and 28% pipeline and LNG Plant Area LANCOs; this apportionment by NEC is further divided by landowners under LBBSA. For example see Angore PRL 11 LBBSA Clause 6.4(v).

70 McIlraith, op. cit., 40.

71 Ibid, 41.

72 Matteo Morgandi, *Extractive Industries Revenue Distribution at the Sub-National Level* (New York: Revenue Watch Institute, 2008). See also Sefton Darby and Kristian Lempa, *Advancing the EITI in the Mining Sector: Implementation Issues*, World Bank's Oil, Gas and Mining Policy and Operations Unit (COGPO) and EITI Multi-Donor Trust Fund. See also Revenue Watch Institute Sub-National Program, *Harnessing Oil, Gas and Minerals for Local Development* (2011).

73 See Ghana EITI Validation Report for design options for including sub-national receipts and income. See IDL Group and Synergy Consulting, *Validation of the Extractive Industries Transparency Initiative in Ghana (GHEITI Secretariat, 2011)*, 24-25 and 33.

5.4 LONGER-TERM IMPACTS

ECONOMIC SUSTAINABILITY

Many of the construction-stage opportunities will taper off over the next few years, and at about the same time, the longer-term revenues and grants will start to arrive in the communities once the gas starts to flow in 2014 or 2015. There is significant anxiety about whether these new benefit streams will be sustainable, or will further exacerbate existing social tensions.

The question of economic sustainability at the ground level has a number of facets to it. Of paramount concern is the drying up of business opportunities once the construction phase is over. This is a valid fear, given that so many of the opportunities at present are provided by the new Project and transport infrastructure, and the need to feed and house the migrant workforce.⁷⁴ If the related opportunities disappear once the construction phase is over, community resentment may spike towards EHL, the Government or other local groups who have benefited from the Project (see Section 5.5 below). These concerns have been expressed not only in the Southern Highlands region to the Otago University Study authors, but also during the Oxfam Australia study by communities surrounding the Project's LNG Plant site in PDL 152.⁷⁵

Augmenting these concerns are related fears about more indirect impacts of the Project on the future of the community. For example, if the migration to the region becomes semi-permanent, how will this affect Landowner relations? Would landholding capacity be able to sustain a long-term increase in regional population?⁷⁶ There are also fears about the observed trend away from food production, towards buying food on the market. If this trend continues, there are some who worry that the attendant loss of skills, especially gardening capacity of the young people, could come back to haunt the community once the opportunities of the construction phase dry up.⁷⁷ And in a more general sense, if the observed trend towards increasing socio-economic and gender inequality in communities impacted by the construction phase continues, this will work against any long-term economic benefits that may ensue.

RISK OF SERIOUS CONFLICT

It will be recalled from chapter 2 that violence has played a role in the life of the Huli people. Along with compensation and discussion, violence has been one of the natural and unquestioned means of dispute resolution for the Huli for generations. Problems arise, it might be argued, only when an outside world, hungry for the underground resources of the region, distorts this system of social relations, which, if not exactly 'harmonious', was nevertheless part of a world 'in harmony'. This is the context in which discussions of violence related to PNG LNG should be framed.

When analysing the risks of conflict in the Project areas, it is important to highlight two particular

scenarios. The first scenario is intra- or inter-clan violence or conflict in the Southern Highlands among Huli groups, or between Huli and other groups who have migrated to the Project looking for economic opportunities. The second scenario is more serious: that of a larger-scale conflict between Landowners/locals in the Hela Province and security forces representing the Government and/or the Project.

We now consider these two scenarios in turn.

Project-related conflict between/among clans

The scenario of intra- or inter-clan conflict in the Project area is most likely to unfold from disputes over land, or to arise out of social tensions related to migration into the area. To date, the land ownership disputes that have occurred have been concentrated in PDL 152 where the Liquefaction Plant is to be concentrated, rather than up in the Southern Highlands. In January 2010, five people were killed in a conflict near the plant site between Boera and Porebada villages as a result of land-ownership disputes related to Project benefits.⁷⁸ In the same month, 270 properties were destroyed, and 11 people were killed by villagers from the neighbouring Erave district, in violence related to the Project.⁷⁹ Currently, the large number of economic opportunities available because of the PNG LNG construction boom seem to be keeping a lid on any potential inter-group conflict in the new Hela Province.

Although some compensation cash handouts have already been made, these are relatively small compared with the large amounts of revenue that will enter into the community once the gas starts to flow. In the long-term, land-related conflicts will be minimised if the revenues are collected fully, managed well, and distributed as evenly and fairly as possible. The main concern involves the potentially unresolved issues resulting from the rushed signing of the Benefit Sharing Agreements (BSAs) before the Final Investment Deadline at the end of 2009. These issues could reemerge if there are less positive benefits to share around than have been promised and expected.

According to recent research conducted in the Project area, land ownership disagreements still persist. In particular, 63 per cent of the respondents to one survey felt that Landowner agreements were a problem or a serious problem.⁸⁰ Furthermore, many respondents in the Otago University Study identified disputes over landownership as the Project's most serious potential flashpoint.⁸¹ Such findings are a cause of concern given the large problems that beset almost all the institutions associated with management and distribution of Landowner revenues.

A secondary concern is the relationship between groups that are indigenous to the Hela region and those who have migrated there looking for work

78 D'Appolonia S.p.A., op. cit., 64.

79 See "11 killed in PNG ExxonMobil liquefied natural gas profits dispute," *The Australian*, 25 January 2010, <http://www.theaustralian.com.au/news/world/killed-in-png-exxonmobil-liquefied-natural-gas-profits-dispute/story-e6frg6so-1225823219984>. Police and ExxonMobil argued the killings were related to "tribal dispute. See Ilya Gridneff, "ExxonMobil denies links to PNG deaths," *Sydney Morning Herald*, 25 January 2010, <http://news.smh.com.au/breaking-news-world/exxonmobil-denies-links-to-png-deaths-20100125-1m8l.html>.

80 McIlraith, op. cit., 32.

81 Ibid, 52-53.

74 McIlraith, op. cit., 43-44.

75 Oxfam Australia, op. cit., 9-11.

76 McIlraith, op. cit., 46.

77 Ibid, 47.

and other opportunities. Widespread migration into the region has already occurred; the risk is that this migration might lead to tensions and an increase in violence. In the Porgera gold mine in neighbouring Enga Province, the spike in violent crime has been associated with the huge amount of migration into the area.⁸²

Operational Disruption and Militarisation

While this first scenario should not be taken lightly, operational disruption and militarisation of the entire area is the much more dangerous possibility. According to the Otago University Study, close to 30 per cent of respondents felt that conflict between Landowners and the Companies was a possibility—a figure more than double the number of those worried about clans/Landowners fighting each other.⁸³

Small-scale incidents of conflict that have occurred to date include: various reprisals against the Companies and those representing them over the issue of employment and working conditions; workers strikes at the LNG Plant, reflecting dissatisfaction with working conditions and pay⁸⁴; attacks by locals against expatriate workers in the Hela Province⁸⁵; foreign workers being attacked at Komo (the site of the airfield)⁸⁶; and, of course, the hostage-taking and occupation of Project sites that occurred in connection with anger over the distribution of the business development payments (see Section 5.2). Fortunately, though troubling, these episodes have been temporary.

What do we currently know about the security arrangements for the Project? First, EHL has designed the Project infrastructure, especially the pipeline, to be as tamper-proof as possible, so as to minimise the likelihood of disruption of the gas flow due to sabotage.⁸⁷ It is worth noting that the fortification of Project infrastructure, while intended to minimise Project disruption, could simply push Project disruption techniques to focus, not on the pipeline, but on human and labour resources.

Secondly, there is a confidential Memorandum of Understanding between EHL and the PNG Government that outlines the various roles that each party is expected to play regarding security. In a reply to a letter from Jubilee Australia, ExxonMobil stated that EHL is committed to doing business “in a way that protects the security of its personnel, facilities, and operations and respects human rights”, but that it is the PNG State that has primary responsibility for “maintaining law and order, including addressing crime and general civil unrest, in the PNG LNG Project

areas”.⁸⁸ The company also stated:

Under the terms of the memorandum, where the government’s capacities or resources are limited, we may provide prescribed support for defensive security purposes only to protect our personnel, facilities and operations - for example, for transportation and accommodation of police in remote Project locations.⁸⁹

The Government’s security apparatus currently in place for the Project contains the following components:

- the local police of Hela Province, who are essentially doing regular community policing;
- three mobile squads of the Royal PNG Constabulary: the same squads who have been operating in Porgera, which are assisting with policing of the Project sites;
- international firms employed by the Project to assist with security. (Two such firms thought to be linked with the Project are: 1) A subsidiary of G4S, the world’s largest private security firm; and 2) Guard Dog Security.)

In early April 2012, the Government announced plans to send squads of the PNG Defence Force to Enga and Southern Highlands Province to quell unrest and violence at the Porgera mine and the PNG LNG construction areas. It is not known at this stage how many soldiers were to be deployed or for how long, although it is suggested that part of the reason for the deployment in the Tari area was that potential unrest could have disrupted the provincial elections in June.⁹⁰

The use of foreign-owned private security firms has been heavily criticised by Former PNG Defence Force Commander and veteran of the Bougainville conflict, Major General Jerry Singarok. Singarok argues that the use of these private security forces pose two separate threats: indirectly, they weaken the strength and the morale of the indigenous defence forces by drawing quality personnel from their ranks; and, more directly, their presence in the Project site is a threat because private security contractors are inherently perceived as more inflammatory by locals, and more prone to violence than domestic forces.⁹¹ Some counter Singarok’s claims by suggesting that the private security firms are better trained and more disciplined than PNG forces, but his public position on the issue confirms that there is indeed a pervasive uneasiness amongst the domestic security forces about the use of contractors, which is in itself troubling.⁹²

Ultimately, the most important factor regarding the security forces is perhaps not their make-up, but in what manner and under what circumstances they may be deployed in the case of Project disruption. On this note, there is cause for some pessimism, given the

82 This crime rate was reduced by the introduction of police mobile squads in 2009 (paid for and housed by the mining company), although these squads have been accused by Human Rights Watch and Amnesty International of burning down an entire village in the process of restoring order. See Human Rights Watch, *Gold’s Costly Dividend: Human Rights Impacts of Papua New Guinea’s Porgera Gold Mine* (Human Rights Watch, 2011), <http://www.hrw.org/sites/default/files/reports/png021webwcover.pdf>.

83 McIlraith, op. cit., 53.

84 See Blackwell, op. cit. As a result of their higher productivity, foreign workers receive higher pay than PNG nationals.

85 Blair Price, “Virtually no security” at PNG LNG sites,” PNG Industry News, 7 September 2011, <http://www.pngindustrynews.net/storyview.asp?storyid=2488704>.

86 “PNG’s Esso Highlands Ltd - security still an issue for LNG Project,” Radio New Zealand International, 22 August 2011, <http://www.rnzi.com/pages/news.php?op=readid=62569>. See also Oxfam Australia, op. cit., 9-11.

87 Field Communication, Port Moresby June 2011

88 Letter from ExxonMobil, 12 June 2012 (see Appendix 1).

89 Letter from ExxonMobil, 12 June 2012 (see Appendix 1).

90 Jeffrey Elapa, “Troops sent to highlands,” The National, 2 April 2012, <http://www.thenational.com.pg/?q=node/30955>.

91 “Exxon Mobil LNG a “very serious threat to national security” says Sandline hero,” Crime and Corruption Blog, 2010, <http://crimeandcorruptionpng.wordpress.com/2010/03/22/exxon-mobil-lng-a-very-serious-threat-to-national-security-says-sandline-hero/>.

92 We would also expect Singarok to take this position because of his major role in the Sandline Affair, where he was, back then, very unhappy (as were many in the defence forces) with the Government’s decision to use mercenaries to fight the Bougainville Revolutionary Army.

Government and the Companies are both dependent on meeting a strict timetable for the deliveries of gas. As was explained in chapter 2, the PNG Government has taken on significant financial liabilities in order to participate in the Project. Although it has to repay many of these before the gas flows, the Government will nevertheless need to apportion some of the Project's early gas revenues to debt retirement. Moreover, it will be relying on the gas revenues to service other spending obligations in its budget. The Companies, for their part, will face significant financial penalties in the case of disruption of deliveries of the gas to the buyers. In both cases, there are significant financial incentives to respond harshly to any sort of sabotage or Project disruption. It seems fair to assume that if there is serious Project disruption, militarisation of the region is a genuine possibility.

The risk of serious conflict attending the Project will, in the end, turn on the experiences and expectations of the Project-affected communities. When the opportunities from the construction phase dry up, the people of Hela Province and of PDL 152 will face the question of whether their expectations of the Project have been delivered. Will the revenues flowing to the communities transform them into better places? This of course depends on how the revenue management structures we have discussed earlier in the Chapter perform. There is a great deal of uncertainty about this. What we do know is that the communities and groups will make their own assessment of whether the Project has been beneficial overall.

What is less certain is the question of whether communities, and in particular, community leaders, will take disruptive action if they grow unhappy with the Project. Many have already gone on record making public threats against the Project and its workers if they do not get what they want. According to Hela Community Care's John Tamita:

It may be a disaster coming up. They've chopped the neck off a couple of Asians already, Asians who worked on the new airfield in Komo. And most likely, its (sic) also going to be taking place here [Tari] too. A lot of our residences demolished; no payment; we are struggling now; our lives become useless, they didn't consider us.⁹³

A recent news item picked up a similar sentiment expressed by a source close to Southern Highlands landowners:

[...] I fear what is coming unless something changes soon [...] We are not being heard and feel we have no choice. We know we will be out-gunned, and Exxon, being an American company, may receive US government support, but this is about dignity and our rights.⁹⁴

Worryingly, the same informant claimed that weapons are being smuggled into the region in preparation for violent conflict if expectations are not met.⁹⁵ The possibility of a weapons' build-up in the region was

raised two years ago in Jubilee Australia's previous report on this subject.⁹⁶

The ingredients for Project-related conflict unfolding in Hela Province are all present: high community expectations, the apparent preparedness of some groups to use violence if necessary, a highly-charged and complex security situation, a government and a company that will likely respond harshly to any sabotage or other acts of violence or disruption. The vital ingredient, however, will be the perception of actors within the Project area of whether the promises of the Project were received. If conflict does break out, the most positive thing that can be said is that it is unlikely to be as long-term or as horrific as on Bougainville.

SUMMARY FINDINGS

- The Hela region has already been transformed, economically, demographically and socially; so far the spoils and benefits of the construction phase have 'papered-over' isolated incidents of social unrest.
- The politics of local-level revenue distribution are extremely complex; the various institutions which exist to distribute the revenues and the business opportunities embody the complex melange of social forces of which they consist. Serious problems attend three of the four institutions examined regarding governance and historical proneness to misuse (the MRDC, ILGs and the EIC/DNPM).
- Transparency for the MRDC, but also for the EIC, could also be enabled by an extension of EITI implementation downward to the local level. Such a move would require reconciliation of revenue amounts in the MRDC-managed trust companies, and within sub-national government accounts with the amounts disbursed to them.
- Many of the construction-stage opportunities will taper off over the next few years and, by 2014 or 2015 when the gas begins to flow, the longer-term revenues and grants will start to arrive in the communities. There is significant anxiety in the local communities about whether these new benefit streams will be sustainable, or whether they will further exacerbate existing social tensions.
- The manner, efficiency and fairness with which the production phase benefits are spent and distributed will probably be key factors as to whether the Project is seen to be a success or a failure in the Project areas. The risk of serious conflict attending the Project will, in the end, turn on the experiences and expectations of the Project-affected communities.
- It is uncertain at this stage whether communities, and in particular, community leaders, will take disruptive action if they grow unhappy with the Project. However, many have already gone on record making public threats against the Project and its workers.

⁹³ "Claims LNG Project could cause unrest in PNG's Hela region," Radio New Zealand, 21 August 2011, <http://www.rnzi.com/pages/news.php?op=readid=62540>.

⁹⁴ Antony Loewenstein, "PNG and Civil Strife is High on the Agenda," Crikey, 16 February 2012, <http://www.crikey.com.au/2012/02/16/png-and-civil-strife-is-high-on-the-agenda/>.

⁹⁵ Ibid.

⁹⁶ Jubilee Australia, op. cit., 42.

CONCLUSION

SCRUTINISING THE POSITIVE PREDICTIONS

It will be recalled from the introduction that the primary motivation of this research was to bring to the fore the official claims about the likely benefit of this historic LNG Project to its host country, as made by its key proponents, and to subject these official claims to critical scrutiny and analysis.

The first two chapters of the Report laid the groundwork for this analysis. Chapter 1 discussed the historical context of natural resource projects in PNG and provided a theoretical framework for considering their impact; Chapter 2 outlined the key players in what is the largest project in PNG history, and one of the largest energy finance deals on record.

The final three chapters of the Report engaged in the analysis of the Project's net benefit to PNG. Chapter 3 subjected to scrutiny the official projections made about net economic benefits of the Project for PNG; Chapter 4 considered how Papua New Guinea's political institutions will likely manage the critical task of holding and administering the state revenues, in light of performance in recent history and the current challenges. Finally, Chapter 5 focussed on the various scenarios that might unfold in the coming years for the people living in the Project-affected areas.

The key findings from Chapters 3, 4 and 5 are summarised below.

EFFECTS OF THE PROJECT ON PNG'S ECONOMY

- The claim that the Project would double the country's GDP has very little basis, despite a willingness for Project proponents to tout this prediction to bolster support.
- Regardless of what decisions are made in terms of how to spend the revenues, the Project is likely to indirectly hurt other sectors of the PNG economy in ways which it is difficult to predict. What is clear is that the sectors worst-affected will be those on which many of PNG's poor are dependent for their livelihood.
- PNG policy-makers face a fundamental tension between trying to use the PNG LNG revenues to help with the development needs of the country on the one hand, and the need to minimise the negative multiplier effects that spending such revenues will have on other sectors of the economy. This is a dilemma which is essentially irresolvable.
- The official Economic Impact Study (EIS) commissioned by the Project proponents acknowledged this tension, noted in the body of its

Report, but nevertheless de-emphasised it in the Executive Summary.

- The most recent economic indicators from PNG, released just before publication of this report, show the PNG LNG Project already creating large, damaging ripple effects in the rest of the economy. Dutch disease is spreading, causing significant harm to the country's non-mining and petroleum export sectors.

MANAGEMENT OF NATIONAL REVENUES

- Serious doubts exist about the efficacy of the institutions nominated as recipients for the substantial National Government revenues for the Project, in particular the IPBC.
- Some progress has been made on revenue management: the Government is in the process of setting up a well-designed Sovereign Wealth Fund, and also appears to be moving slowly towards a commitment to the Extractive Industries Transparency Initiative (EITI).
- Nevertheless, the establishment of a Sovereign Wealth Fund will not, in and of itself, guarantee a positive outcome. Political reform in PNG is the most important insurance against official abuse of the SWF. Given the complex nature of politics in PNG, such reform is a long-term project involving the gradual integration of modern-state democratic traditions. This is more likely to take place, if at all, across decades rather than in the space of a few short years.

CONSEQUENCES OF THE PNG LNG AT THE LOCAL LEVEL

- The Hela Province has already been transformed economically, demographically and socially by the Project; the spoils and benefits of the construction phase have 'papered over' any significant social unrest thus far. The greatest risks of conflict will come when the construction phase ends and the production phase begins.
- The politics of local revenue distribution at the local level are opaque, and the various institutions which exist to distribute the revenues and the business opportunities embody the complex melange of social forces of which they consist. Warning signs from Landowners that they will not respond well to unmet expectations and disappointments have been paid little heed by PNG LNG proponents.
- The manner, efficiency and fairness with which the production phase benefits are spent and distributed will probably be the key factor as to whether the

Project is seen to be a success or a failure in the Project areas. Such matters are impossible to predict at this time, but if important segments of the community feel excluded from the Project's benefits, the potential for conflict will increase.

In the first chapter of the Report the following question was posed in the same way that Nigeria has developed an 'oil complex' - a fusion of state and society, with the institutions of international oil extraction - is PNG following suit with the emergence of its own 'gas complex'? On the basis of the evidence above, the answer is, 'very possibly, yes'. It will take a herculean effort on the part of many groups of people to avoid this eventuality.

THE ROLE OF OUTSIDE GOVERNMENT ACTORS

A secondary aim of this research was to examine the role of the overseas governments in financially and diplomatically supporting the Project, particularly in the light of the above findings. In a regulated market economy it is the role of governments to monitor the actions of corporations under their purview, to ensure they operate with due diligence; even more so when the governments, either directly or indirectly, provide financial support for their domestic companies to participate in an overseas project. The key findings from the Report regarding the role of international governments in enabling the PNG LNG Project are summarised below.

- It seems clear that without the financial and political support of outside governments, the Project could not have gone ahead. Although it was neither the lead corporate actor (ExxonMobil) nor the other lead actor (PNG Government), Australia's role in supporting PNG LNG through the Trade Ministry and EFIC was particularly important.
- Australia's decision to make a public investment in PNG LNG was approved in a customary closed session by Australian Federal Cabinet on the basis of a 'whole-of-government submission to Cabinet'. Though never released to the public, it is reasonable to assume that this briefing would have included discussion of the risks attending the Project, as well as the likely 'national interest' benefit to Australia.
- Despite being aware of the sorts of risks that have been raised in this Report, the Australian Cabinet and the Trade Ministry took the decision to support the PNG LNG Project.¹ We can surmise that the decision was taken for three principal reasons:
 - 1) EFIC, the Government, and key politicians sought to show support for exporters and business groups, and to forestall any negative reaction from these groups (either publicly or privately) for failure to get behind the Project.

¹ Through concerns raised directly by Jubilee Australia with the relevant Ministry in the Australian Government about PNG LNG and diplomatic communications very critical of the regime in Port Moresby made by Australian officials both within the Trade Ministry and with foreign counterparts, we must conclude that the Australian Government was at least aware of the risks of directing EFIC to support the PNG LNG Project financially. Philip Dorling, "Australia, US damn PNG's rotten political practices," *The Age*, 3 September 2011, <http://www.theage.com.au/world/australia-us-damn-pngs-rotten-political-practices-20110902-ljq9a.html>.

- 2) The Government desired to retain influence in PNG, spurring support for the Project. Officials may have reasoned that the possibility of the Project going ahead without Australian support was a risk not worth taking.

- 3) A genuine belief that PNG LNG would be of net benefit to the country is likely to have led some government officials to act on its behalf. We can only hope that this Report raises doubts on this matter.

Other ECAs have justified their support on the basis of business for their domestic companies, either those directly involved in the Project, or those likely to win lucrative contracts associated with it; or they were motivated to secure a purchasing agreement for their domestic gas suppliers. Other considerations may also have been at play in determining the support of, for example, the US Government.²

The evidence collected here strengthens further the argument that has long been made by Jubilee Australia, that decisions by the Australian Trade Minister to place facilities on the publicly-funded National Interest Account of EFIC require greater scrutiny. The final report of the Productivity Commission Inquiry into Australia's Export Credit Arrangements, released May 2012, marks an important step forward in this reform with its recommendation:

The Australian Government should clearly and publicly articulate justification for a national interest account facility after it has been approved by the Minister.³

RISKS VERSUS BENEFITS

In concluding this Report we seek to integrate the key findings into an evaluation of how the risks and benefits of the PNG LNG are shared among the groups and actors involved. In short, what seems to be revealed is how the odds are stacked in favour of the international governments and businesses involved in the PNG LNG Project, and against the interests of the majority of the PNG population.

INTERNATIONAL PRIVATE ACTORS

The risk/benefit profile looks somewhat similar for each of the major international private actors: the foreign companies in the PNG LNG joint venture (and their investors), the private financiers and the buyers. The chances are high that the construction phase will finish on or close to schedule and that gas will start to flow by 2015. It is also likely that, even if there are small scale problems, it will not seriously impede the Project. All in all, this means that buyers will receive their desired gas, the private banks will have their loans repaid, and the joint venture Companies will see their share price rise. The only major incident that would disrupt this rather happy outcome would be a large-scale Project disruption where financial penalties could

² As Secretary-of-State Clinton's comments to the Congressional Committee suggested, geopolitics may have played a role.

³ Australian Government Productivity Commission, *Australia's Export Credit Arrangements* (Commonwealth of Australia, 2012), Recommendation 9.5, 287-288.

hurt all involved. Profits would be affected, as some investor returns would be less than they had hoped for.

INTERNATIONAL PUBLIC ACTORS

In the case of foreign governments (principally through their export credit agencies), the risk/benefit analysis looks a little different. In both the problem-free and the minor disruption scenarios, there is significant benefit to be gained: the credit provided will be recouped, and valued constituencies (resource, construction, and gas supply companies) will receive a boost from vital business contracts. Except perhaps for nearby Australia, the political fall-out that might result from minor disruptions is unlikely to affect the outside governments involved. Serious disruption (the least likely scenario) would be more troublesome for Australia, and perhaps other overseas governments as well—not only because of the financial pain caused by potential default or suspension of loan repayments, but due to the likelihood of raising embarrassing questions about their financing decisions.

THE PNG PEOPLE AND PNG LNG LANDOWNERS

For the citizens of PNG, including PNG LNG landowners, the risk/benefit profile appears the least encouraging of all. For both groups, the number of factors on which the net outcome depends makes it impossible to predict with any confidence what the impact will be, even in the event that no serious problems arise with the Project. Most likely the outcomes will be mixed. The risks are high for Landowners, given that even a small-scale Project disruption could have major impacts at the local level, and seriously undermine social harmony and development. It goes without saying that the unlikely scenario of severe Project disruption in the Southern Highlands would be catastrophic for the people of the Hela Province. Severe disruption could spark civil conflict, militarisation of the region, and potential human rights abuses.

The local-level revenues hold almost as many potential risks as benefits, since the institutional structures in place to manage them, and the political context surrounding their delivery, pose many significant challenges. Some individuals and groups will certainly benefit, but others are just as likely to miss out, which will no doubt cause disappointment and other problems. In the end, it is difficult to imagine that PNG LNG revenues will trickle down to the rural poor.

In summary, if PNG LNG is considered an investment with various different stakeholders, those likely to accrue the largest proportion of benefits are the international actors, while those bearing the largest proportion of risk are the people of the Hela Province and of PNG generally.

Much of the reason for this imbalance must be traced back to the way in which the PNG LNG deal itself was negotiated, an issue that was discussed at length in Chapter 2.

- The various legal agreements made by the PNG Government, including stabilisation contracts

and generous tax concessions, clearly favour the companies. Regrettably, the deal struck is not uncharacteristic of resource agreements negotiated between powerful multinational companies, and weakly-democratic, rent-seeking states. As a result, both present and future generations of ordinary PNG citizens have been made to bear many of the financial risks of the Project.

- The government (not individual politicians, but ultimately the people of PNG) bears many of the financial risks of the Project.
- Even greater points of concern are the speed with which the agreement was signed, and the way in which the government handled the negotiations with the Landowners. Improper consultation, and pressure applied by the Government to force the landowners to sign may ultimately pose the greatest risk. That these circumstances were, in fact, predicted by the Social Impact Assessment's specialist before the process had occurred, suggests that the Companies in general, and ExxonMobil in particular, cannot escape some of the blame for this development, although it was not technically their responsibility.

WAS THERE ANY ALTERNATIVE?

Was there any other choice for PNG but to undertake the Project in the manner and with the timing proposed? This is an anticipated response to the risk/benefit asymmetry presented above. It is here that we should consider the comments made by Paul Barker, Director of the Institute for National Affairs, at the 2010 Mining and Energy conference in Port Moresby:

PNG has extensive natural resources, but in the past major extractive developments, combined with poor investment conditions and deficient expenditure planning and governance, have encouraged 'boom and bust'. As with Botswana's experience, a country benefits from its resources, not by waiting for the income to address governance issues and fund institutions, but by establishing and applying firm governance conditions from the start, so that when additional revenue is received the mechanisms will be resilient, with the proceeds invested and beneficial, rather than seductive and harmful. As required in the National Constitution, the country must utilise its natural resources wisely in the interests of both current and future generations, without jeopardising the prospects of other industries and communities. That will be the challenge for now and the future.

Barker went on to say that:

PNG would do well to carefully plan and phase major projects, realising that the resources still in the ground in some cases will provide a safer investment than [if] placed in some risky domestic or overseas deposit, or other investment vehicle, whilst better enabling the country to benefit steadily from its finite resources, rather than

unduly liquidate them upfront, when the benefits might flow unduly offshore. This debate might not necessarily please some investors or resource hungry consuming nations, but it is a justified debate for PNG to have over its own long term future [...].⁴

Barker's comments highlight an often-forgotten fact: countries have a choice about when and how to exploit their natural resources. With the information we have and the amount of uncertainty that still prevails, we cannot say whether it would have been better for the PNG Government to walk away from this deal and leave these gas resources in the ground until another opportunity to exploit them arose. We can say, however, that the context, the timing and the negotiation processes surrounding PNG LNG have resulted in the greatest risks of this Project being borne by the people of PNG and the greatest benefits likely to fall to the foreign actors who are developing these gas reserves for their own ends. This should raise a genuine concern for all those who care about the future of PNG.



Walking into Nogoli.
Photo credit: James McIlraith/University of Otago.

⁴ Barker, op. cit., PNG's Economy 2010.

APPENDIX 1

ExxonMobil Exploration and Upstream
Ventures Limited (Singapore Branch)
1 George Street #15-02
Singapore 049145



12 June 2012

Ms. Carmelan Polce
Deputy Director
JUBILEE AUSTRALIA
NCCA Offices
Level 7
379 Kent Street
Sydney NSW 2000

Dear Carmelan,

I write in reference to your letter of 14 May and our follow-up phone conversations. In the attached document I have replied to the questions in your letter, using *italic text* to differentiate between your original text in the questions and my replies.

As we discussed on the phone, it would be preferable for ExxonMobil to have the opportunity to see your paper before it is put in final form, as was committed to by Executive Director, Adele Webb at the outset of Jubilee's research.

Please let me know if you have any further questions about the attached responses or other issues.

Sincerely,

A handwritten signature in blue ink, appearing to read "Robin McClellan".

Robin McClellan
Senior Government Affairs Advisor
Asia Pacific

Incorporated in the Bahamas
Foreign Company No. T09FC0078D
An ExxonMobil Subsidiary

have supported health centers with equipment and repairs, and provided seating and other equipment for churches.

ExxonMobil Responses to

Questions from Jubilee Australia

Re: Jubilee Australia research paper on PNG LNG Project

Further to our recent discussions, Jubilee Australia is nearing the completion of a final draft of our research report on the PNG LNG Project. Before we conclude our work we invite Exxon Mobil to provide further comment. We have identified parts of the report that might be contentious or of concern to Exxon Mobil. We welcome your comments both in the areas we have identified and more generally should you have further matters to address.

We have established that responses from Exxon Mobil on the items below would enhance our reporting. The items of inquiry fall into two categories: 1) information that will confirm our understanding of the project terms and conditions, and 2) sections of the report that relate directly to public postings and statements made by Exxon Mobil that we hope you will review and confirm.

1. Corporate Social Responsibility Projects

Our paper discusses the corporate social responsibility initiatives undertaken by the PNG LNG Project joint venture partners, including, in general, environmental internships, training programs, sporting equipment and grants for public works like libraries, and in particular, the Health Foundation funded by Oil Search. Would Exxon Mobil like to add anything further or in particular to this section?

It is difficult to assess what additional information would be useful without having seen the information you have included in the draft.

Our quarterly Environmental and Social reports which you can access at <http://www.pnglng.com/quarterly-reports/>, provide information on many of the initiatives the Project supports. They are many and varied, and I will highlight just a few of them here.

Our investments in the community focus on health, education, agriculture and empowerment of women. These initiatives are based on targeted research and analysis including community mapping, livelihood assessments and assessments of local industries and existing community development institutions.

For example, through the Project Community Development Support plan, the PNG LNG project has supported education programs in more than one hundred elementary schools, including providing school packs, desks, and books; upgrading facilities, and providing road access. We have built community centers and installed necessary equipment; provided baking ovens, training, and equipment; and sponsored sports equipment and training. We have supported

Our approach is about forging relationships, promoting opportunities and developing mutual respect and trust by working alongside people. Our aim is to build capacity, not dependence. Throughout the Project footprint we are engaging women's groups, youth groups, ward councils and their committees in different partnership initiatives.

One such example is a women's group in Kikori called Delta Green Field Marketing Limited. They now have a contract to sell vegetables to Project construction camps. We are assisting to build management and financial capacity through a range of training initiatives and the construction of a nursery to help grow their business and therefore the social well-being of the group which is made up of over 500 women from six villages in the Kikori Delta. Programs in other areas offer instruction and exposure to fisheries management and animal husbandry.

We also have funded the Business Professional Women's Club of Port Moresby to provide scholarships to underprivileged girls in tertiary and secondary schools throughout Papua New Guinea in a program that benefits hundreds of girls and women. The Project also supports a joint effort by the World Bank and the PNG Chamber of Mines and Petroleum, the Women's Resilience Program, with the goal of enhancing women's ability in the areas of basic financial skills, family life improvement, and income generation.

Another program is the Personal Viability Training for community leaders, which provides women and other leaders with tools for improving livelihoods and managing social issues. To date, more than 250 people have participated in the training which covers respect for others, promoting positive thinking, budgeting for family needs and financial management. Other programs include Directorship and Management training and Strategic Planning workshops for community and business leaders. Marital Relationship Training benefits participants by helping to reduce alcohol consumption, episodes of gender-based violence and concurrent partnerships, while also encouraging increased school attendance.

The Project is also making an important contribution through workforce development, with more than one million hours of training having been provided. More than 8,500 Papua New Guinean citizens have received training for construction and production roles. PNG businesses are also involved, with Landowner Companies receiving significant contracts for Project-related activities. Many of those have received assistance and training from the Enterprise Centre, which has supported more than 1,300 businesses.

An example on the environmental front is the Project's support for the Piku Conservation Project, which is focused on raising awareness about the threatened Pig Nosed Turtle species which is in decline due to long-term over-harvesting of the turtles and their eggs. The Project is also working collaboratively with Conservation International to identify and establish community managed Conservation Areas.

John

John

pipeline' concept was abandoned in 2006, and in 2007 efforts were focused on negotiations to market the gas by shipping LNG to China and Japan.

By 2007 the PNG government indicated that for this new LNG concept project they would rely upon many of the fiscal terms that had previously been agreed for the Queensland pipeline proposal. Marketing negotiations and economic viability assessments continued for another thirteen months, and the PNG LNG Gas Agreement was executed on 22 May 2008. The negotiation of the Gas Agreement for the PNG LNG Project stretched over many months and relied on the previous negotiation that it was conducted over many months. The current Gas Agreement was negotiated vigorously by the State using external consultants to assist it in those negotiations.

The Gas Agreement provides the fiscal platform for the LNG project. It sets out the State's obligations in regards to the provision of exemptions and fixed rates of duties, excise, royalties, taxes and State participation.

Part of the agreement records that the State will translate these obligations into binding legislation, which was done in 2009 with the passing of many Acts to amend tax, duties, excise, and tariffs rates legislation.

The Fiscal Stability Agreement (referred to in your question 2) is an agreement under which the State guarantees the fiscal stability of the PNG LNG Project by reference to the law in force at the time. The Fiscal Stability Agreement was attached to the Gas Agreement as an exhibit and was entered into in 2009 (after the passing of the legislation referred to above) in accordance with the Resource Contracts Fiscal Stabilization Act 2000.

In summary, the Gas Agreement is a fiscal agreement, negotiated with the national government over a period that extended from the late 1990s through to 2008.

4. The Benefit Sharing Agreements:

Can Exxon Mobil provide comment on the statement made by Professor Laurence Goldmann in the Social Impact Assessment published in January 2009 about the likelihood that the Benefit Sharing Agreements would have problems and that this was a concern given the centrality of the agreements to the success of the PNG LNG project. (EIA Section 5.2.3)¹

Goldmann wrote that the Benefits Sharing Agreements process should be done according to the following principles:

"Transparency – community consent to and knowledge of all constituent benefits sharing agreement processes.

Equity - that no project stakeholder constituency, ethnic, gender or generational, is disadvantaged or disempowered by the Benefits Sharing Agreement process.

RAW

2. Fiscal Stability Agreement:

We have examined the draft Fiscal Stability Agreement that formed an attachment to the 2008 Gas Agreement between PNG and the participants in the PNG LNG Project. It is our understanding that the contract was fully executed in 2009, but we have not succeeded in obtaining the final version. We would like to verify what is in the Fiscal Stability Agreement. Will Exxon Mobil share that document with Jubilee Australia?

The Fiscal Stability Agreement was ultimately signed on 2 April 2009 in exactly the same terms as the draft version that appears as Exhibit P to the Gas Agreement, which you already have. Please see additional comments below in response to question 3.

3. Executing the PNG LNG Gas Agreement:

PNG government officials have claimed that Exxon Mobil rushed them into signing the PNG LNG Gas Agreement. Statements made by Deputy Prime Minister Sam Abal in comments to landowners in January 2011 were reported in a posting on the LNG Watch Papua New Guinea blog. See Patrick Talu, 'Exxon Made Us Do It: Sam Passes the Buck' (31 January 2011), The National.

Can you provide comment on the statement? If it is accurate then perhaps Exxon Mobil can outline its justifications for exerting what the PNG government officials suggest was time pressure in the execution of the Gas Agreement. If it is not accurate, then we invite Exxon Mobil to provide comment on the conditions under which the parties were operating at the time of the execution of the document or more generally on the finalization of the agreement.

We certainly disagree with this statement and it is our understanding that Mr. Abal denied having made the statement shortly after the article was published in a newspaper. We further recollect that the article was not attributed to any journalist.

I would like to put the agreement in context, as you request: The Gas Agreement (executed 22 May 2008) was the culmination of many years of economic analysis for the viable production and sale of gas from reservoirs in the Southern Highlands.

Gas was first discovered many decades ago, but was considered uneconomic to produce until the late 1990s when the worldwide price of gas escalated and technology for drilling and shipping LNG improved, resulting in lower overall project costs.

Typically, gas is sold into markets with 20 or 30 year obligations of continuous supply, and so the marketing and economic feasibility studies for a potential gas project usually occur prior to applications for development licenses. In this case, economic analysis and marketing was considered by ExxonMobil from the late 1990s. From 2001 to 2004 we looked closely at the economic viability of selling the gas via a pipeline to Queensland and a Gas Agreement for that Project was executed with the State in June 2002. After years of analysis, the Queensland

RAW

Manageable – that representation has a number that can reasonably be assembled at one time or in manageable groups to facilitate negotiation.

Mandated – that representation reflects, and be publicly seen to reflect, the mandate of the affected and impacted project landowners.”

Whilst the Manageable principle may have been adhered to, there is doubt about whether the BSAs occurred in a process that was Transparent, Equitable or Mandated as Goldmann recommended. Goldmann commented further:

“However, while the Benefits Sharing Agreement is the cornerstone for social development in the project area over the next 30 years, adherence to these principles is likely to be encumbered by the inter-ethnic baggage of both pre and post-colonial relations in the region”

We welcome your comments.

We agree that the principles Laurence Goldman suggests are soundly based, and that the complex social environment in the project areas presents a challenge in relation to the State grants. However, Esso Highlands Limited is not a party to the LBBSA, the responsibilities belong to the PNG government and its citizens, and we do not have oversight or power over the administration of project benefits by the State. That said, we are an interested party in the impact of the State’s management of the distribution of cash benefits and other commitments, and we support the State agencies as possible and appropriate.

5. Exxon Mobil MoU with PNG Government:

Will Exxon Mobil share with Jubilee Australia the Memorandum of Understanding signed with the PNG Government regarding the respective obligations of each party regarding security? Would Exxon Mobil like to comment on the MoU for the report?

Esso Highlands Limited is committed to conducting business in a way that protects the security of its personnel, facilities, and operations and respects human rights. Our practices and operations reflect the spirit and intent of the Universal Declaration of Human Rights as it applies to private companies and the Fundamental Principles and Rights at Work of the 1998 International Labor Organization Declaration.

We recognize, however, that the government of the State of Papua New Guinea has the primary responsibility for maintaining law and order, including addressing crime and general civil unrest, in the PNG LNG Project areas. A written memorandum with the PNG government identifies these responsibilities. In this respect, we do not influence the day to day operations or decisions of the PNG Police; we merely report incidents as they occur. Under the terms of the memorandum, where the government’s capacities or resources are limited, we may provide prescribed support for defensive security purposes only to protect our personnel, facilities and operations --for example, for transportation and accommodation of police in remote project locations. The MOU is in a similar format as agreements other resource companies have in PNG and is also similar to agreements that ExxonMobil affiliates have

R. Paul

entered into in other nations where the Police have not had the capability to operate without such support.

Esso Highlands Limited’s agreement with the PNG government also requires that police personnel receive appropriate training, including in respect for human rights. We have worked with police officials to ensure that training that meets international human rights expectations has been provided.

6. Exxon Mobil position on EITI implementation in PNG:

Our paper makes the following comment on Exxon Mobil’s position on the implementation of the EITI in PNG. Can you please confirm or correct our interpretation of the Exxon Mobil position.

“What has been the position of Exxon Mobil regarding EITI implementation in PNG? Exxon Mobil is an EITI-supporting company. Having occupied a seat on the EITI board between 2006 and 2009, the company continues to serve as a board alternate. In a letter to Jubilee Australia, Exxon Mobil said the following:

“We believe that to be successful, any transparency initiative must apply to all companies with an interest in a country’s extractive sector, protect proprietary information and respect host government laws or contractual obligations; EITI meets these criteria.”

This is still our position.

While the company has been involved in the establishment of transparency agreements, including implementation of EITI, in many countries in which it operates, including Azerbaijan, Chad, Equatorial Guinea, Indonesia, Iraq, Kazakhstan and Nigeria, no such agreement has been reached in PNG. The Exxon Mobil website states:

“As part of our commitment to honest and ethical behavior, we offer our assistance to countries seeking to implement greater transparency and disclose financial information. We provide assistance to our newest partners as they seek to implement greater transparency. At the same time, we recognize that transparency initiatives can only be sustainable when national governments have ownership and responsibility....In Papua New Guinea, our project has the potential to boost the country’s gross domestic product and provide a catalyst for employment and further industry development. Project team members from Esso Highlands Limited are active members of Transparency International and acknowledge the government’s bilateral Memorandum of Understanding.”

We are pleased to be part of the multi-stakeholder process as the government, civil society, and industry work together to develop proposals related to the introduction of EITI in Papua New Guinea.

R. Paul

APPENDIX 2

TRANSPARENCY INTERNATIONAL (PNG) Inc.

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E-mail: tjpng@daltron.com.pg

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21/05/09

TIPNG INVITATION TO BE INDEPENDENT OBSERVERS AT THE BSA FORUM WITHDRAWN LAST WEEK.

Transparency International PNG (TIPNG) today expresses grave concern at the level of consultation and oversight at the LNG Benefits Sharing Agreement forum being held in Kokopo, ENB. These concerns are being raised after an invitation to TIPNG from Esso Highlands Ltd. to attend the forum as an independent observer was unexpectedly withdrawn.

TIPNG believes it was not given sufficient time to prepare for the forum given the original invitation was extended by Esso Highlands Ltd on **April 9th**, only eleven days before the initial scheduled date of the forum. Given the importance of the BSA forum and the legitimacy of its outcomes TIPNG met with Mr Robert Vanveenendaal, a senior officer with Esso Highlands to clarify the role of the Independent Observers and the processes to be followed, with a view to ensuring the integrity of the process and reporting was protected.

TIPNG was pleased with the response from Mr. Vaneenendaal, who expressed Esso Highlands commitment to transparency and it's appreciation that the involvement of Independent Observers was pivotal and very important. He confirmed that the Report from the Independent Observers was a critical document that investors, financiers, shareholders, customers and other stakeholders would look at carefully as they evaluated their involvement in the massive LNG project.

In spite of the short notice of the invitation to provide an Independent Observer TIPNG confirmed its commitment to participate and commenced a process to select a person of high calibre, with appropriate experience and aptitude to take up this role. Consequently TIPNG would like to express disappointment that the invitation was withdrawn, given its eagerness to act as an observer at the BSA forum and the gravity of the matters to be discussed.

TIPNG stands by its right to enquire and carefully evaluate it's position regarding participation, as it was unwilling to be dragged into a what it believed to be an uncertain process given the lack of consultation regarding the roles of independent observers at the BSA. TIPNG reiterates its willingness to participate as an observer on terms that would not have compromised its integrity as an anti-corruption organisation.

TIPNG was pleased to note that the Report of the Independent Observers was to be published, including on their website, and therefore it is important for the Department of Petroleum and

Energy to disclose to the public the names of the independent observers that did participate at the BSA Forum in Kokopo.

In concluding TIPNG has questioned why the original invitation was not extended by the Department of Petroleum and Energy. The role of Independent Observers and their Report is a critical element of the whole BSA process and as such the Department should have been taking a lead role in ensuring invitations were sent out in a timely manner so that organisations such as TIPNG could have responded appropriately. The silence of the Department raises concern regarding the Department's own commitment to transparency and consultation in the BSA process. TIPNG believes the Department of Petroleum and Energy, as well as the Minister for Petroleum and Energy Mr William Duma, must explain why such a critical element of the BSA forum was not or could not be handled by the Department. TIPNG believes the Department must offer comment on this important issue, particularly in the light of widespread media reports suggesting the disorganization and mismanagement of the BSA forum.

The LNG project is important to Papua New Guinea and her future generations and TIPNG stands firm to ensure that principles of transparency, accountability and fairness remain cornerstones of negotiations that take place.



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Sovereign Debt and Poverty

Jubilee Australia
September 2009




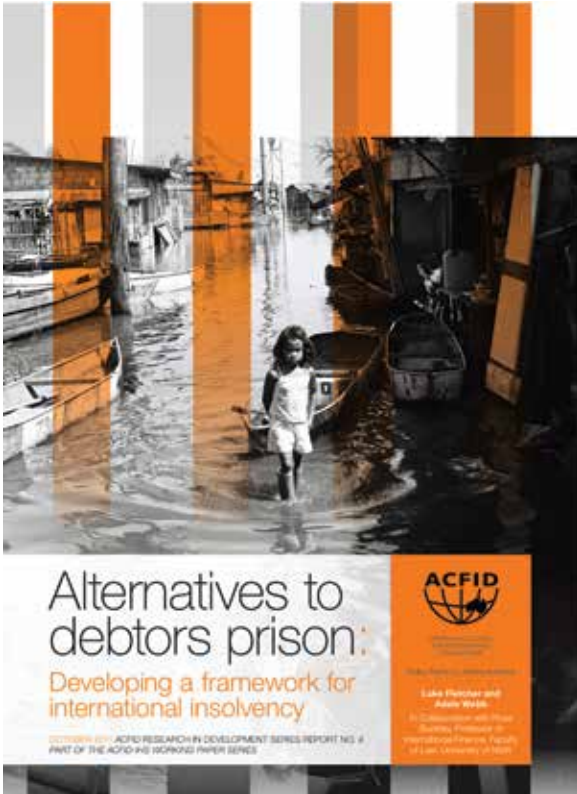
Debt-for-Development Exchanges in Australia: Past, Present, and Future



Working paper on
Sovereign Debt and Poverty

Jubilee Australia
October 2010





BACK COVER:

(Left) Working on the road to Tari.
 Photo credit: James McIlraith/ University of Otago.

(Centre) Walking to Nogoli.
 Photo credit: James McIlraith / University of Otago.

(Right) Bouganville 2012.
 Photo credit: Antony Loewenstein.




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