Panguna Mine (Credit: Bougainville Copper Ltd)

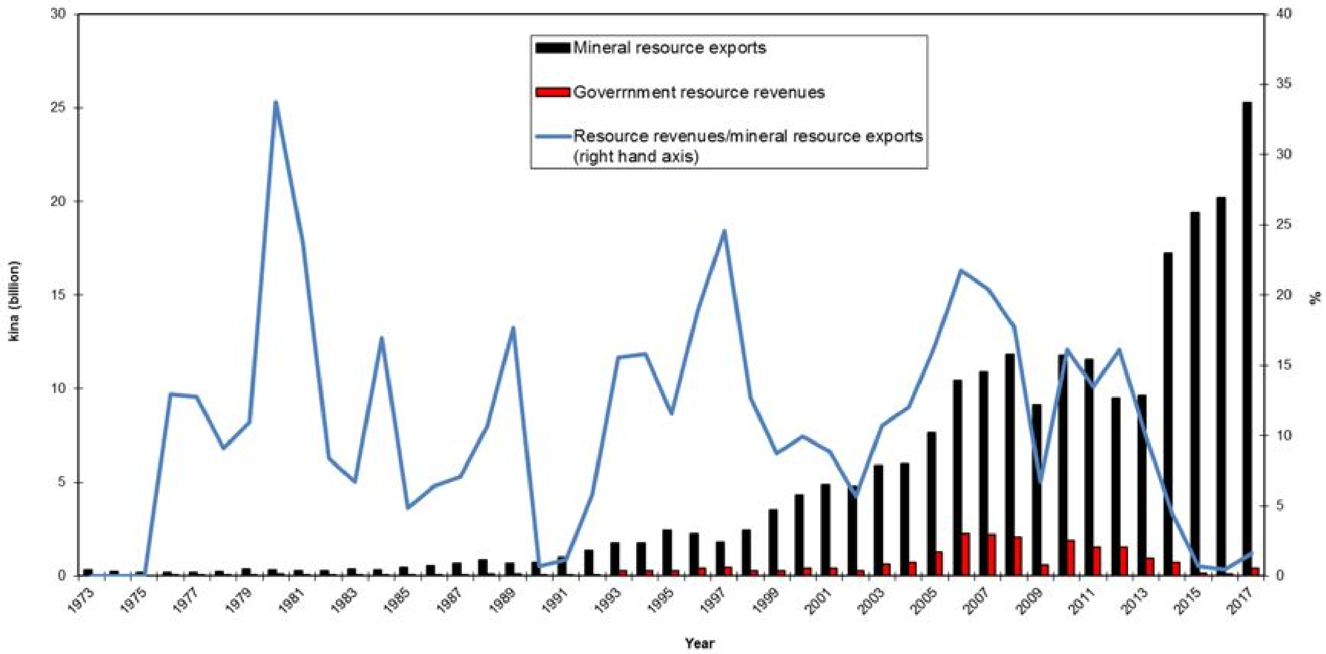
Papua New Guinea's disappearing resource revenues

By Glenn Banks and Martyn Namorong
15 August 2018

Government revenues from Papua New Guinea's mining, oil and gas sector have essentially dried up. With the ongoing effects of the devastating earthquake in Hela province, the eruption of election-related violence in the Southern Highlands, a significant budget shortfall, and a foreign exchange crisis driving business confidence down, the resources of the government are severely stretched… and the massively expensive APEC meeting looms in November.

In this context, the drop in government revenue from the resource sector is staggering, and accounts in significant part for the growing fiscal stress. Figure 1 shows the extent of the issue: in 2006-2008, according to BPNG figures, the government collected more than K2 billion annually from the sector by way of taxes and dividends, on mineral exports that had just topped K10 billion for the first time. In 2017, the figure is just K400 million on exports of K25 billion – a revenue reduction of more than 80% in the same time that exports have increase by 150%! Government dividends and corporate taxes made up just 1.6% of the value of exports in 2017 (and that was a significant increase over 2015 and 2016). If we take the long-term average share of the value of exports that the government has received (at a little over ten percent), this points to a potential 'hole' of at least K8 billion over the past four years, an amount that would go a long way to covering the current fiscal deficit.

Figure 1



Source: BPNG. Resource revenues are defined as "MRSF receipts," that is, the receipts that used to go into the Mineral Resource Stabilisation fund. Even though the MRSF no longer exists, BPNG still records resource revenues, which include corporate tax and dividend payments from resource companies.

There are some precedents for the rapid drop in government revenues from the sector, as Figure 1 show. In 1990 and 1991 – just as the 'resources boom' triggered by the Porgera gold mine and oil production at the Kutubu oilfield began – revenues collapsed, largely due to the closure of the Bougainville copper mine in 1989; and again, briefly in 2009 due to the onset of the global financial crisis in 2008. But neither of these has been as deep or as sustained as the current hole.

A full explanation of the precipitous decline in resource revenues is beyond the scope of this analysis. Clearly, a number of factors are involved, including a fall in commodity prices, major construction and expansion costs (which attract accelerated depreciation provisions) and generous tax deals. The revenue dry-up of the past four years also reveals that the State bears a disproportionate share of the risks associated with resource projects and investments. If we go back to the original intent of the post-Independence mineral policy, it was to translate mineral wealth into broad-based development across the whole country:

'…known mineral resources should be developed for the revenue they can provide to the Government' (PNG Department of Finance 1977: 2).

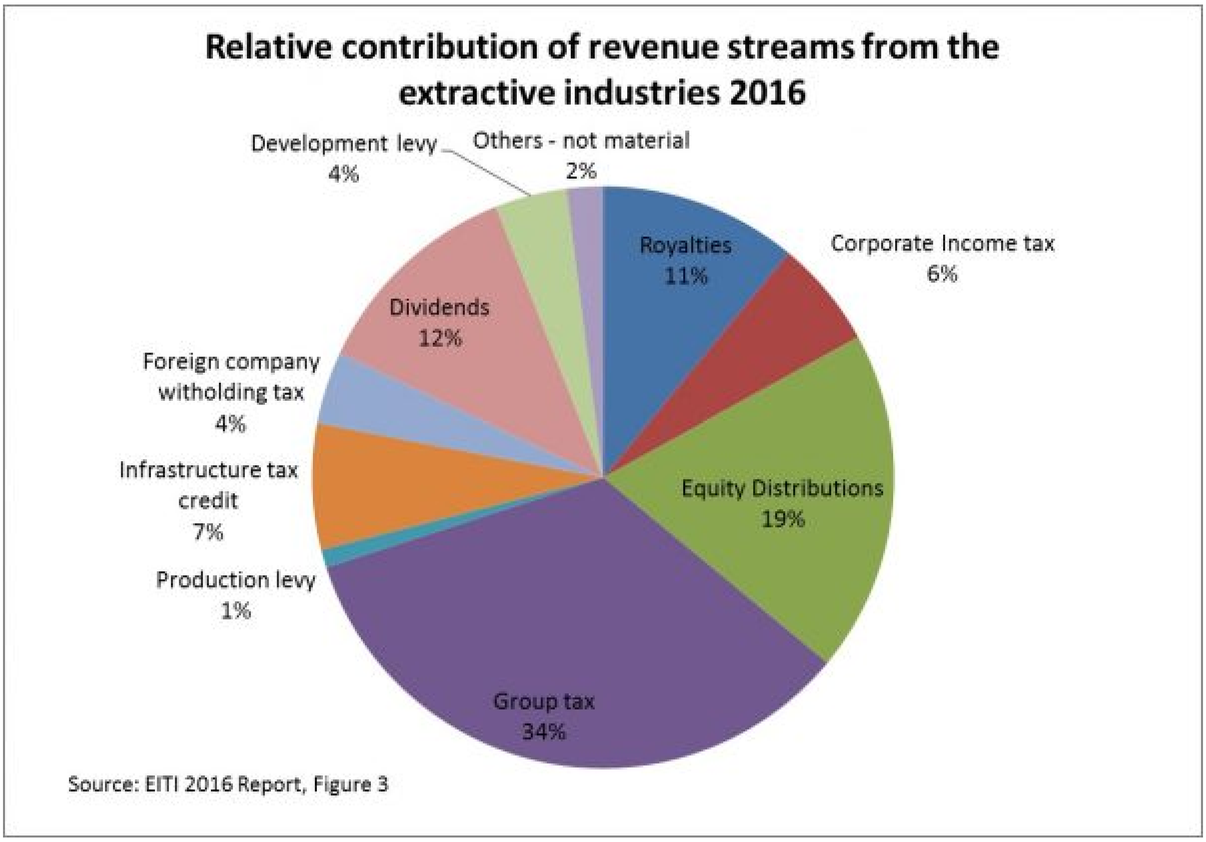
This clearly has not happened in the last four years. And certainly the Treasurer can't be critiqued for commissioning yet another fiscal review: this seems appropriate, although whether it effectively addresses broader issues of a 'fair share' of mineral wealth remaining in PNG remains to be seen.

While there is much less money coming from the resources sector, there is at least better data than there used to be. The Extractive Industries Transparency Initiative (EITI) is a global initiative begun in 2002 to give transparency to what were regarded as often opaque flows of resource revenues from multinational companies in the extractives sector (especially oil) to the state in the countries in which they were operating. It is a voluntary initiative in which countries (and companies) can elect to become a 'candidate' country, and so long as they are able to be compliant with EITI standards, they can be admitted as a full member of EITI. The key requirement is to be able to report in a reliable way (through third party audits) on the revenues paid by companies, and reconcile these with payments received by the different arms of the state. The involvement of all parties – companies, governments and civil society – and public communication around the event and its products is also seen as central to both transparency and raising awareness of the nature of resource revenues and their destination.

PNG initiated its involvement in EITI in 2012. Four annual EITI reports have so far been produced (for the years 2013 to 2016). These reports provide an increasingly rigorous and transparent set of data on flows from the sector to the government, and identify additional revenue streams to the government than what BPNG use (and have used for the past 40 years). When all the additional revenue streams that EITI identify are included, the total share of the value of mineral exports rises to around 6.5% for 2017, up from the 1.6% based on the BPNG data. EITI is not without its problems and the most recent PNG country report identifies areas where it needs to be strengthened in PNG, and a focus on companies rather than operations can lead to the obfuscation of total flows and payments from each mine, oil and gasfield. In the PNG context, an examination of the sub-national flows and audit trails is also significant, and an initial study into this is underway.

One surprising revelation from EITI is that the single largest revenue stream from the mining, oil and gas sector to the government for at least the last two years has been so-called "group taxes": the taxes paid on the wages and salaries earned by employees in the sector (Figure 2). These were worth more than K500 million in both 2016 and 2017, and in 2016 represented 34% of the revenue streams from the sector to the government, as identified by EITI. This is significantly more than the K46-88 million in corporate income taxes, K200 million in dividends paid to the State, or the almost K200 million paid in royalties in 2017. These group taxes are likely to be a more stable revenue stream than taxes or dividends – the workforce is unlikely to expand and contract to the extent that it impacts on the taxes they pay (leaving aside construction phases), or at least not as much as global commodity prices and profitability. But – and here we come back to the issue of PNG securing a fair share of its mineral endowment – this is a tax on the labour used to extract the resource, not a means of necessarily securing a direct share of the value of the resource itself.

Figure 2



The second area where EITI has revealed some interesting questions is around the operation of the Infrastructure Tax Credits (ITC). ITC originated in the sector in 1992 when the Porgera Joint Venture negotiated with the state to use a portion of their taxable income to directly provide infrastructure for surrounding local and provincial governments in exchange for a tax credit on this spend. Over the years the value and the uses of the ITC have varied, including at times supporting various national projects, and has been the subject of debates in various reviews as to its value. In 2016, four companies reported expenditures of K135 million in tax credit projects to DNPM[i], a significant amount that could well have contributed significantly to local and provincial development aspirations… but we don't really know given the relatively poor reporting of the outcomes of these expenditures. More significantly, though, it is difficult to reconcile the size of these expenditures with the actual taxes paid by the four companies, which come in at well under K100m in total. That tax credits have come to exceed tax payments should ring alarm bells, and would explain why the government has in fact put a temporary stop on them.

Going forward, we would suggest two additional areas of focus, based on the above analysis. This first is local procurement. What is clear from the EITI reports (and earlier work by Banks (1990) on BCL) is that extraction of minerals is an expensive process, and a significant amount of the value of the mineral resource is spent by the companies on the labour, machinery, fuel, food, and the multitude of other costs needed to extract and export the mineral resource. An analysis from the last year of the Bougainville Copper Ltd mine at Panguna revealed that an estimated two thirds of the value of the mine accumulated directly outside Papua New Guinea, and indirect or second round spending would increase this (Banks 1990: 108). Imported materials and services made up 23% of the total value of the gross revenue of the minerals exported, cost of sales (all spent offshore) another 13%, depreciation 8% and dividends to non-PNG shareholders 12%. Local content spend on materials and services sat at just 5.5%, less than a quarter of the equivalent imported costs, while in total local wages and salaries were around two-thirds of the expatriate salary costs, despite the much greater numbers of local employees.

A long-standing objective and challenge for the State has been to find ways to ensure a larger proportion of these capital and operating costs are spent on PNG-based labour and other inputs. Plans at most of the major operations have been successful in localising the workforce significantly, hence reducing imported labour (and costs) at operations over time, although foreign labour continues to be important during construction. In terms of the goods, services and materials used to construct and operate a mine though, there appears to be scope to increase the proportion that is spent and retained locally. In large part this is tied to corporate and state support for a stronger local small business sector that can effectively service these mines (and potentially service the growing extractives industry across the Pacific).

The second area to which attention needs to return is the Sovereign Wealth Fund (SWF). This Fund, which would serve the dual function of saving a component of the resource revenues and having a portion committed to developmental needs through the budget, is in place (in terms of the legislation for it) but has not yet been implemented by the government. This well-proven mechanism for translating immediate resource revenue into a long-term sustainable fund can play a critical role in reducing the volatility of flows to the government. Ironically it may be that the factor holding back the government from moving on its implementation is the dire need for all the resource revenues right now. But neither is it sensible to wait for revenues to return to high levels before initiating the SWF: it will almost be certain that political and bureaucratic processes would delay the first flow of revenue to such an extent that several years' worth of revenues that could kick start the fund would be lost. In other words, in many ways this period of low revenue is an excellent time for the Fund to begin.

So, the answer to the question of where have all the resource revenues gone, is not a simple one. The EITI reports show that a range of factors at the different operations (accelerated depreciation, tax holidays, ITC and re-capitalisation in plant expansions etc), have impacted on the revenue flows to government. To this we can add global commodity price drops, a compromised fiscal regime and some less-than-transparent governance structures and processes. The fact remains though, that over the past four critical years in its development, Papua New Guinea has missed out on a 'fair share' of the value of its mineral resources that have been extracted.

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[1] Although confusingly there are different figures recorded as tax credits claimed by the companies from IRC – where the total credit offset against tax from three of the four companies come to K54million.

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