

Papua New Guinea and the Natural Resource Curse



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Abstract: Several empirical studies have found that when exports are concentrated in natural resources countries experience slower rates of economic growth. Various potential channels for this relationship have been identified including Dutch disease, volatility in the terms of trade, and impacts on governance. This paper explores whether Papua New Guinea (PNG), a resource rich state in the South Pacific, displays signs of suffering from the natural resource curse. The paper finds some evidence of Dutch disease in the decline of local manufacturing. This may also be exacerbated by large scale exports of liquefied natural gas (LNG) in future years. In addition, the paper finds that extractive industry governance is a pressing challenge for PNG and makes suggestions for reform in revenue management and spending.

JEL Classification: Q33, Q34, O13

Key words: Papua New Guinea, natural resources, natural resource curse, extractive industries, Extractive Industries Transparency Initiative (EITI), Dutch disease, good governance

Executive Summary

The 'natural resource curse' refers to the observation that some natural resource-rich countries experience lower economic growth than some natural resource-poor countries. For countries like Papua New Guinea (PNG), which rely on the extraction of natural resources (NR), the possibility of such a 'curse' is a pressing concern.

Studies have identified three channels that could lead to a negative relationship between an abundance of natural resources and lower economic growth. These are: (i) Dutch disease, under which a real appreciation of the currency leads to a decline of non-NR tradable sectors such as manufacturing; (ii) high volatility in the terms of trade, which can lower the efficiency of economic activities; and (iii) governance weakness induced by competition over control of resources and leading to sub-optimal policies including ineffective spending of NR revenues.

In the case of PNG, recent data suggests that the country is experiencing some symptoms of Dutch disease. And future risks are likely to be exacerbated by increased exports from the large Liquefied Natural Gas (LNG) project coming on-stream in the near future. PNG is also susceptible to pronounced changes in its terms of trade, threatening the productivity of the whole economy.

However, weak governance is the single factor most likely to undermine prospects for sustainable growth. Data shows that the rents coming from natural resource activities are not being effectively spent and are failing to translate into improvements in economic and social indicators. Institutional factors such as rent seeking, corruption, poor governance, and underdeveloped human capital could continue to hinder PNG's successful use of its resource rents.

To address these issues, the government of PNG must implement policies that improve macroeconomic management and lift the country's institutional quality. The main policy recommendation of this paper is the establishment of an auditing working group consisting of government officials and non-governmental members (including civil society representatives such as professional experts), whose function would be to oversee the efficiency of the overall Natural Resource Revenue Management, including natural resource revenue collection and its expenditure. This entity could be called the Accountability in Natural Resource Management Working Group (ANRMWG) and would provide both advice and auditing.

Political leaders should see the ANRMWG as a driver of improved governance. Besides achieving more effective management of natural resources, ANRMWG could also provide lessons for civil society on how to effectively monitor the government in order to promote accountability. By improving accountability and the functioning of its institutions, PNG could turn the natural resource curse into a blessing.

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