

Local Content Policies In Minerals-Exporting Countries: The Case of Papua New Guinea

Overview of the Mining Sector

Papua New Guinea (PNG) has been dependent on mineral exports since the development of large scale mining in the 1970s. Mineral exports typically account for 70% to 80% of total exports over this period. Most recently, mining has been overshadowed by coming onstream in 2015 of a large-scale LNG project.

The main mines currently operating include Simberi (gold), Lihir (gold), Porgera (Gold), Tolukuma, Sinivit, OK Tedi (copper and gold), Ramu (nickel), Hidden Valley (gold and silver). A number of projects are also at an advanced stage of development or are beginning including at Yandera, Freida and one of the world's first deep sea mining projects at Solwara 1. In addition, some 280 exploratory licences have been issued, coupled with around 350 outstanding applications for licences to explore.

A number of mines have ceased operation, the most notable of which is the Panguna mine in Bougainville. Panguna produced copper and gold from 1972 until 1989, when disputes over the distribution of benefits and environmental damage led to an armed insurrection by landowners. The conflict was eventually settled with an agreement that established an autonomous region in 2000. The conflict has had far-reaching effects for mining operations and policy establishing "the primacy of local over provincial and national interests" within large scale projects in PNG (ERM, 2010).

At present, overall policy around the mining sector is in a state of some flux. Amongst recent developments, the government has been working on a new Sustainable Mining Development Policy (SMDP) which is yet to be adopted. The government has also been in the process for some time of establishing a Sovereign Wealth Fund (SWF), although this is understood mainly to deal with the royalties from the new LNG projects. The future of the OK Tedi mine has received particular attention as a result of its complex ownership structure prior to its effective nationalisation in September 2014, in a measure that may have further long-term implications for mining in the country (Hayes, 2014). Around the same time the government ordered a review of all Memoranda of Agreement (MoAs) for currently operating mines.

Local Content Requirements and Initiatives

Policy objectives

Policy around mining in PNG recognises the need for foreign investment for the development of mineral deposits due to limited internal capital, technology and expertise; the focus of policy since independence has therefore been on extracting government revenue from the sector and then employing these funds for broader economic development within the country (Banks, 2001).

However this approach has evolved over time and through practice in response to tensions including those at Panguna, "with greater emphasis now placed on the landowner rights and local development" (ERM, 2010). As such, PNG now differs from some other countries in that local content requirements – inasmuch as they formally exist – tend to be embedded within "Benefit Sharing Arrangements" (BSAs) that are negotiated and agreed on a project-by-project basis between firms and local communities.

Regulatory frameworks

Although they are negotiated with local stakeholders, there is a national legal basis for BSAs and a defined mechanism within national legislation. While the 1992 Mining Act declares that all mineral resources are state-owned, it stipulates that the negotiation of a mining contract between the state

and a firm must be accompanied by a "Development Forum",¹ within which the Benefit Sharing Agreement is agreed.

As such the sequencing of events is that an application for a mining lease is made, and then a community level Development Forum is held, before a mine development contract is signed. Although there appears to be no formal requirement for any specific outcome from the Development Forum, in practice the implication and expectation is a Benefit Sharing Agreement, typically through a set of MoAs signed between different stakeholders including national and provincial governments, the mining firm and local communities.

A key feature of Benefit Sharing Agreements, previously known as "Integrated Benefits Packages", is that they are broad in scope. As such, they cover areas related to ensuring local content, in terms of providing jobs to the local community and support and preferences for local businesses particularly in the initial construction phases, as well as CSR-type commitments on provision of social services and infrastructure, and also royalty arrangements and compensation for environmental degradation. In the case of the Lihir Gold Mine for example, the Lihir Sustainable Development Plan:

"...covered a wide range of initiatives around capacity building, trust fund payments, compensation, training and localisation, infrastructure and utility development, town and village planning, commercial and contract management opportunities, and social wellbeing" (Kemp et al., 2012)

In terms of provisions related to local content, the lack of any obvious overarching principles within the Development Forum and BSA negotiating process make it difficult to assess their relationship to more traditional national local content policies. However, Banks (2001) lists a number of typical benefit streams commonly included in early BSAs, from which it is possible to discern a pattern for the types of initiatives and provisions adopted, including:

- Compensation
- Occupation fees
- Royalties
- Wages
- Equity
- Business Contracts
- Social Investment

It is worth noting that ERM (2010) describes BSAs as more akin to transfer of power and benefits from the national level to the community level, rather than imposing any new obligations on firms (who would have to pay the above benefit streams in any case). However, this conclusion may be more relevant for the overall financial implications, than those that are more closely related to LCPs such as on wages and business contracts.

There are a number of reasons why the model makes sense for PNG, where mines are often located in extremely remote areas that are far from the reach of any government services. In essence the community focused model is a response to the fact that the main obstacles to extraction are local land issues and community-level resistance. The Development Forum is therefore an effective mechanism for reaching a consensus between the claims of the national and provincial governments and local communities, bringing about a clarification of landowner issues and clarifying roles, responsibilities and the distribution of mining benefits.

¹ Specifically section 3 of the Act states that: "A Development Forum shall be convened by the Minister before the grant of any Special Mining Lease (SML) to consider the views of those persons whom the Minister believes will be affected by the grant of that SML and shall be conducted by the Minister according to such procedures as will afford a fair hearing to all participants."

Table 1. Summary of LCPs applicable in Papua New Guinea

Type of Requirements	Details of requirements	Applicability in PNG	Relevant legal framework
Numerical requirements	Ownership requirement: Possibility of state participation	There is no requirement for state involvement. The state has a right, but not an obligation, to acquire, directly or through a nominee, up to a 30 per cent participating interest in any mineral discovery made during the exploration phase.	Mining Act 1992
	Permits or licensing requirements	In order to obtain a mining lease, firms must agree to a local development plan within the context of a Development Forum of local communities and national and local governments. Typically these result in Benefit Sharing Agreements and include the following elements: Compensation; Occupation fees; Royalties; Wages; Equity; Business Contracts; Social Investment.	Mining Act 1992
Consultation with local communities	Prior consultations with local communities before development of activities	Law requires that prior to the granting of a mining license there must be consultation within a 'Development Forum' with local communities and stakeholders, leading in practice to a benefit sharing arrangement (see above).	Mining Act 1992

Insights on the Mining Value Chain

To date, very few BSAs have received any in-depth scrutiny,² or been subject to detailed monitoring of outcomes. The exception is the case of the Lihir agreement where the original 1995 Integrated Benefits Package was revised in 2007 to put greater emphasis on long-term outcomes, with the agreement being subject to a small number of external evaluations.

In terms of providing jobs to local communities, it is generally unclear whether employment requirements are set out clearly, the level of requirement specified in each of the BSAs, and if so what mechanisms exist to implement this. However, ERM (2010) notes that "salaries paid to local employees constitute the most widely spread and consistent flows of money into the local community". The OK Tedi mine employs some 5 500 people either directly or indirectly while Lihir mine employs 2 100 full-time employees – of which 34% are Lihirian and 91% overall are PNG nationals.

In terms of the preferences given in contracting local suppliers, ERM (2010) also notes that these are the "most sought after economic benefits of the development of large-scale mines". At Porgera for instance, between 1988 and 2000 over 6 000 operations contracts worth 100 million kina (USD 32 million) were awarded to Porgeran businesses. In Lihir, most of the involvement of business came during the initial construction phase:

"Landowners had created an umbrella firm, the Lakaka Group of Companies, with local shareholders and outside parties to provide goods and services to the mine. Members of the small business associations under the umbrella company had been given preference over non-Lihirian firms. Sixty formally, structured businesses, owned and operated by locals, were awarded construction contracts totalling USD 50 million by the end of 1996, but this declined following completion of the construction phase. [...] Contracts issued to local businesses in 2001 amounted to USD 5.4 million."

Following the revised agreement there was also evidence of contracts being awarded to local suppliers, with almost PGK 187m (USD 61 million) in contracts awarded to local suppliers in 2008, including PGK 93m to landowners and landowner joint ventures (see Table 2 below). At the same time, the apparent success of the policy is tempered by the overall conclusion that:

"The reality, however, is that many business contracts issued to local contractors hold more prestige than economic value because of the high costs of operating in PNG, cultural constraints on good business practice and relatively inexperienced business owners. Local contractors are frequently obliged, through lack of business capacity, to enter into joint ventures with external companies, further diluting the value of contracts to the community."

² See for example CCSI's Community Development Requirements: Mapping, database and issues at stake on <http://ccsi.columbia.edu/work/projects/community-development-agreements-frameworks-and-tools/>

Table 2. Distribution of benefits under the LSDP in 2008

Nimamar Rural	Royalties	3.1%
Local Level Gov't	Special support grants (estimated)	0.9%
Contracts	Landowner contracts	53.9%
	Landowner JV contracts	14.9%
Direct Payments	Royalties (block holders)	2.1%
	Economic plant compensation	0.1%
	Noise, light and dust	0.0%
	Land use rental	0.7%
	Community assistance and donations	1.3%
	Integrated Benefit Package commitments	4.7%
	Lihirian salaries	6.7%
Village development	Grants (Landowner association)	0.3%
	Village development scheme housing	0.8%
	Village development scheme grants	0.4%
	Integrated Benefits Package infrastructure and utility capital projects	10.1%
Total		100.0%

Main properties

The Development Forum and Benefit sharing agreement (BSA) process has been relatively effective at involving local communities and fostering a balance between local and national concerns that is an essential prerequisite for mining projects to successfully commence in PNG. It has been a fundamental issue, given the history of mining in PNG, to find consensual agreement with relevant local-level stakeholders, including defining who these are, before attempting any mining operations and obtaining relevant authorisations.

A key feature of the BSAs is their bundling of local content requirements alongside other benefits within an integrated package. The aim is to increase opportunities for local participation, and distribute benefits amongst different stakeholders (landowners, the local workforce, local firms, etc.).

Since the BSAs are negotiated between mining firms and key stakeholders in remote areas of PNG, these agreements tend to be context-specific. There is little or no harmonization among agreements at the national level. If ill-managed and not well coordinated with national policy objectives, BSAs may lead to outcomes that are sub-optimal at the national—much less at the global-level. This might occur for example if the BSA leads to the contracting of local firms at the expense of more efficient national firms, or the building of local infrastructure that is of little use in terms of the development of the country as a whole.

Some of these agreements are far-reaching and may even include policies that are generally implemented at the national level such as royalty rates and payments. This introduces a large element of uncertainty among investors, who may hesitate to invest in PNG if there are no clear indications as to which mining policies may be subject to negotiation with local officials who may have evolving interests.

BSAs, like the 2007 Lihir agreement, are a good opportunity to align stakeholders' long-term sustainable development objectives including issues that will come up post mine closure. This has not often proved to be the case however and will be necessary in order to ensure a positive impact.

In terms of the effectiveness of BSAs in actually achieving their development outcomes, the picture is rather unclear. Despite the general perception that some benefits have been delivered, most notably on the employment aspects, there are challenges of enforcement. A major problem is that BSA outcomes tend to be poorly monitored, leading to a lack of clarity over whether requirements are actually being met (Filer, 2012).



More Information

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For further information on our work on trade in raw materials, contact:

Jane Korinek, OECD Trade Policy Analyst

jane.korinek@oecd.org

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