



Privatisation in Papua New Guinea— where at and where to?

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The present government in Papua New Guinea has decided to make privatisation one of its top priorities. It has two reasons for doing so—to raise revenue in order to retire existing debt, and because it sees the continuation of government ownership as an inefficient way of providing services. The sheer act of privatisation will not bring about all the things the government wants to achieve. The emotional issues of ownership will need to be addressed by ensuring maximum transparency in asset sales and by giving all Papua New Guineans an opportunity to participate in the process.

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There is some confusion about what is meant by privatisation. In its purest form it means that the state transfers its assets or service functions from public to private hands. The term is also loosely applied if the state disposes shares in an asset even though the entity has not been fully privatised. There are varying degrees of disposal, and often governments sell off assets progressively. Examples of this would be the Australian government's sale of Telstra, its telecommunications company—which has had two share issues but for which the majority shareholding is still held by the federal government—and the proposed method of disposal of the Finance Pacific Group in Papua New Guinea.

Other processes are often confused with privatisation. Corporatisation is one. The process of corporatisation is a change in the method of running an entity. It means that a statutory body is no longer run by an appointed board of directors according to government policies and wishes. The entity is set up as a commercial body and expected to run as a profit-making organisation. Directors are subject to the penalties of the Companies Act and have responsibilities under that Act. Theoretically, a corporatised body should not be subject to political direction that forces management to act in a non-commercial manner. That distinction has not yet been understood in Papua New Guinea and some corporatised bodies still



experience considerable political meddling, for example, Air Niugini.

History

To understand privatisation properly, we have to understand why governments get involved in business and how these businesses have operated.

Since medieval times, governments and kings have been involved in business. They owned land and they owned the labourers, sometimes as slaves and sometimes as serfs, who were technically not slaves but had to do what the landlord or the king told them. The proceeds of these enterprises went toward the government of the country.

The evolution of the modern state meant that some services were too big and too expensive for a single person or company to own or build for their private use. Roads, bridges, telephones, electricity, airlines and many other services were built and operated for the common good and for common use. In most cases, they involved very large capital outlays which would not have a short to medium-term economic return. Often they were not subject to the notion of economic returns but were provided on the basis of vague notions of nation building. This was loosely known as the creation of social capital, and, until the 1970s, when privatisation began in earnest in Chile in 1974 and in Britain under Margaret Thatcher in 1979, governments of developed as well as developing countries believed that this was the path to greater efficiency (Sader 1995).

It was estimated that state-owned enterprises (SOEs) accounted for 10–20 per cent of gross national product in much of the less-developed world in the mid 1980s.

- In Mexico, 150 SOEs existed at the beginning of the 1960s; estimates put the figure at around 600 by the mid 1980s.
- In Brazil, there were 150 SOEs at the beginning of the 1960s and approx-

imately 700 by the beginning of the 1980s.

- In Tanzania, there were 50 SOEs in the mid 1960s and 400 by the late 1970s (Berg 1987:23).

Some of these services were provided free of charge and some were provided as a semi-commercial service that consumers paid to use. Sometimes consumers paid the full price, but sometimes they paid less than the full cost of providing the service because the government considered that the service was important for development or social reasons.

There is a body of economic theory on this subject known as public expenditure theory. This looks at the way to optimise government spending and the tradeoffs between private and public expenditure. Essentially, the theory deals with the efficiency of providing goods and services that serve more than the individual and that are necessary or conducive to economic and social development.

In Papua New Guinea we have had all of these combinations. Some bodies, like the Harbours Board, are based on full-cost recovery. Others have been price controlled, do not fully recover costs and receive grants from the government to subsidise the shortfall.¹ Some organisations cross-subsidise the provision of goods and services in remote areas by making urban areas pay more than the cost of providing the service while charging rural areas less than the cost of providing it. Most utilities in Papua New Guinea operate this way. This is because governments have tried to ensure that the majority of Papua New Guineans who live in rural areas and rely on smaller towns for their services are not worse off than those who live in the big cities.

Initially, the government had to invest in many of Papua New Guinea's utilities. The market was small and there was not enough capital available for the large and lumpy payments necessary to create electricity



supplies and communications networks. In the early days, many of these utilities were subsidised by the government, because there was no way that they could be supplied at either a market or even a cost price.²

Prior to independence, the government set up a number of statutory institutions such as the Electricity Commission (Elcom), Posts and Telegraphs (P&T), the Housing Commission, the Harbours Board and others. Since independence, it has continued to create statutory bodies, such as the Water Board, Eda Ranu, Provincial Development Corporations, and some specialist bodies for very specific tasks, such as the various agricultural industry corporations.³

Like other governments around the world, the PNG government has been grappling with how best to run these statutory bodies and what policies to apply to them. In 1979, the government requested assistance through the Finance Department for the International Monetary Fund (IMF) to review government policies towards statutory institutions and, in particular, to determine what pricing and dividend policies were appropriate.⁴ The result was a report, known as the Floyd Report, which concluded that

- the government should clearly spell out its objectives, both financial and non-financial, for commercial statutory authorities (CSAs) so that management knows what is expected of it
- prices paid by consumers should cover the social opportunity cost of inputs
- capital is not a free good but must earn its opportunity cost
- when prices are altered, say for distributional reasons, the commercial statutory authorities should be paid an explicit subsidy to cover the resulting losses
- the commercial statutory authorities should not be exempt from paying dividends, taxes and duties, and loan funds should not be subsidised

- all CSA investments should go through the government budgetary process
- the Department of Finance and the National Planning Office should be represented on CSA boards (Millett 1993:7).

It is interesting to note that there was no mention of privatisation in the report. Generally, world thinking still recognised the role of the state in the provision of goods and services, especially in developing countries. The report resulted in the government setting a dividend policy for statutory institutions and subjecting some of them to taxation. The managers of some of these institutions resented this strongly and some actively set about to disregard the policy. The government did try to enunciate its policies in various planning documents (Department of Finance 1980), but it never really laid out clear guidelines for the CSAs.

In 1981, a follow-up to the Floyd Report was well received in the Department of Finance and National Planning Office. Many economists in these organisations wanted to exercise control over the CSAs, which they felt were operating as empires under the guidance of technocrats who paid little attention to the economic consequences of their actions (Whitworth 1993). Not surprisingly, the report spoke directly to the beliefs of these economists, confirming their suspicions.

Writing in 1982 for the Institute of National Affairs, Michael Trebilcock observed that 'the performance of many public enterprises has been weak by almost any measure...' (Trebilcock 1982:14). Trebilcock went on to criticise heavily the rationale behind the Floyd Report, arguing that

[r]equiring them to act just like private enterprises...denies any rationale for their existence because private enterprises almost always outperform public enterprises in terms of purely commercial performance.



Subsidies could just as well be given to private enterprise, which he considered to be more efficient than public enterprise (Millett 1993).

Here we find the first instance in the PNG context of the literature reflecting the change in global thinking about state involvement in business. Proponents of the market and private provision of services were gaining the ascendancy.

Privatisation began to enter the policy debate. Millett reports that it had 'entered the general policy mix in the mid 1980s and the Papua New Guinea Shipping Line was sold to Steamships' (1993:12). In 1988, the government started selling shares in some of its statutory bodies to try and improve management and performance through private-sector representation on the boards.

As long ago as 1990, the government created the national privatisation committee to improve productive and allocative efficiency. This was because the overall return to the government's K232 million investment in CSAs was only 5.6 per cent, somewhat short of the target of 15–20 per cent that had been set by the government (Millett 1993). The bodies that were set for corporatisation beginning in 1987 were the

- National Statistical Office
- National Computer Centre
- Government Printing Office
- Registrar General's Office
- Public Curator's Office
- transport-shipping operations
- procurement and storage service.

The progress and results of this policy have been varied, and few of them were ever privatised. The transfer of the Registrar General's Office to the Investment Promotion Authority has been a spectacular success. In two or three years, the entire commercial sector of the economy was brought back under control, moribund companies were struck off, and company returns were required to be lodged. The efficiency of the

office improved enormously—enquiries that would previously have taken months to be answered were now dealt with over the counter, and essential national records were maintained and updated.

On the other hand, the removal of the state from shipping services at national and provincial level has meant that many of the small communities that were served (at subsidised rates) by the government fleet are no longer served by anyone. Often, where a service does exist, the freight rates are so high that the people in these communities cannot afford to use it anyway.⁵

Since 1990, the government has had a policy to privatise as many government assets and services as it can. This is in line with international thinking where the role of the state in providing services has been found to be inefficient and far too costly. Even the leaders of the former Soviet Union and the largely command economy of communist China have recognised the need to privatise some or all of their enterprises. There are some very important lessons to learn from these countries.

The most important is the need to ensure that assets are disposed of in an orderly and transparent manner. The experience from the former Soviet Union has been that assets were disposed of through a variety of closed and uncompetitive methods, often to local functionaries and crime czars, leading to a concentration of ownership and creation of some extremely rich and monopolistic entrepreneurs.

Progress in Papua New Guinea has been very slow and only a few entities have actually been privatised during the past decade. Those that have been privatised were generally small and not politically sensitive, such as the Kurakakaul abattoir in East New Britain and the sale of the government's share in New Britain Palm Oil Development Ltd. The sale of the government's share in New Britain Palm Oil Development was controversial because of the way in which it



was done, rather than because it was being done at all.⁶ Recently, the sale of Orogen Minerals, which held the government's shares in a number of mineral and petroleum projects, was successful with shares being taken up all over the world.

The privatisation process also gave birth to an expensive entity called PNG Holdings Ltd, which was supposed to facilitate the process. Apart from providing very good salaries to a number of expatriates close to the government of the day, it failed to make any significant progress. This has caused a degree of scepticism about the present process. It was reported that the new Privatisation Commission would require a budget of more than K11 million for salary packages alone, with salaries ranging downward from K849,000 and 20 positions receiving packages of more than K200,000 (*Independent*, 17 February 2000). Positions are still being filled at the commission, but at the time of writing it had not yet occupied its own office space.

As part of his mini-budget in 1999, the new Prime Minister and Minister for Finance, Sir Mekere Morauta, announced his government's intention to privatise as much of the government's activities as possible in order to reduce government debt (Morauta 1999). Those who had attended the 1998 National Economic Summit would not have been surprised by this announcement. Sir Mekere, then the Minister for Planning, and guest speaker Professor Ross Garnaut both advocated the sale of government assets and privatisation of services in order to reduce the crippling national debt burden, which was consuming about 25 per cent of the national budget in interest payments alone. Sir Mekere estimated that the government could raise as much as K1.5 billion from asset sales over three years.⁷ Subsequent revelations about the parlous financial state of some of these institutions makes it very unlikely that anything like this sum will be realised (*National*, 13 October 2000). Sir Mekere also

stated that there would be efficiency and equity gains from privatisation, but failed to spell out how these would be achieved.

Rationale

There are two main reasons why governments around the world have decided to privatise their activities—to increase efficiency and to raise revenue. Papua New Guinea has decided to follow this path for both these reasons. Other reasons are to spread the ownership of capital and participation in the economy and to provide an impetus for the development of a capital market. There are some government-owned statutory bodies that are not suitable for privatisation, and these should be corporatised and constituted under the Companies Act to introduce the disciplines on directors that the Act provides.

The argument for efficiency is based on the fundamental assumption that private enterprise is more efficient than government in providing essential services. It is argued that the pressures and disciplines imposed by the market place and competition are far superior to any conditions imposed by governments in guaranteeing that goods and services will be produced as cheaply as possible. In large and complex economies, the evidence is that this can be achieved—in Britain and Australia, utilities prices have actually been reduced substantially by privatisation and the introduction of competition.

This has not been at the cost of quality of services, which have improved as a result of competition.⁸ In Papua New Guinea, this result will not be automatic because of the existence of natural monopolies and the present trend to cross-subsidise between low-cost large centres to high-cost small centres.⁹ The government will have to be very careful in its approach to privatisation if it is to guarantee that existing services continue



to all centres without a reduction in quality or increase in cost.

Purists argue that the market will provide the necessary stimulus to efficiency in Papua New Guinea, but this is by no means clear. It is recognised that there will be community service obligations¹⁰ which may run counter to the aims of pure economic efficiency. The government has vaguely recognised this and has had consultants looking at the issue. However, neither it nor the Privatisation Commission has announced any policy directives on how they will address this fundamental and very complex issue.

One possibility is the 'golden share', where governments continue to hold a share, or a number of shares, that gives them a controlling interest in the privatised enterprise. This allows them to ensure that community service obligations are met. This solution, however, will always mean a considerable reduction in the market value of the enterprise, because it will entail a less than optimum private-market solution.

In some countries, there is a major incentive to privatise because commercial statutory authorities have been a significant drain on the budget. In Papua New Guinea this has not been such a problem because the government has refused to fund CSAs, often to their detriment. The 2000 Budget had no recurrent funding for the Electricity Commission, Harbours Board, or the Post and Telecommunication Corporation. There was provision for some development expenditure—the Electricity Commission received K1.9 million for rural electrification, and the Post and Telecommunication Corporation received K1.2 million to extend services to Western province.

A number of macro policies will require reform if the promised efficiency gains are to be made. Two of the most important are price control and wage fixing. It will not be possible to privatise Papua New Guinea's CSAs if price controls are imposed that

prevent them from making a profit. The price control mechanism in Papua New Guinea has been very controversial over the last couple of months with CSAs, as well as private companies, complaining that they have been prevented from passing on cost increases, particularly those that have resulted from the recent international increases in oil prices.¹¹

The wages policy was liberalised in 1992, but there is currently a strong debate about reintroducing a much higher minimum wage due to inflationary pressures brought about by currency devaluation. The current chair of the Privatisation Commission stated that there would be no reductions in employment as a result of privatisation which is, by definition, not in his power to decree (Institute of National Affairs and Transparency International 2000).

The successful sale of SOEs will also depend to some extent on the overall state of the PNG economy. If the economy is perceived by investors to be doing well and there is rising confidence, there will be more interest and the price for the enterprise will be higher. If the level of investor confidence is low, the level of interest will be poor and this will be translated into lower prices for the enterprises.

If the government's credibility is low and it wants to sell off its assets, it is then open to the 'Privatisation Trap' (Summers 1994), where governments sell off assets at lower than their potential value because of discounting owing to fear of government regulation. Another side to the trap is that the government relaxes those regulations and the purchasers make windfall gains through the introduction of efficient management. In this case, there will be pressure from unions and others either to buy back the enterprise or to expropriate some of the gains, which will damage its credibility.

Papua New Guinea is a small and physically isolated country. There are three or four urban centres that could possibly



sustain basic utilities on a full cost recovery basis. It is possible that electricity, telephones and water could be provided cheaper to Port Moresby as a result of privatisation. This is simply because of the size of the market, which allows considerable economies of scale in the provision of essential services

The distribution of these services to small and isolated communities is very expensive and is made harder by the very rugged terrain that they have to traverse. If these services were to be privatised and left to the market, most of the smaller provincial centres would no longer receive telephone communication or electricity (unless new technology were introduced). Furthermore, service charges would have to be increased substantially, placing them out of the reach of most business and private consumers.

The government will have to make sure that privatisation of its statutory bodies does not adversely affect the provision of services in rural areas. Papua New Guinea is still very much at a formative stage of development. It has a high rate of urbanisation in its major centres, but the majority of people still live in rural areas as semi-subsistence farmers. Failure to provide services at a reasonable cost in the smaller centres will accelerate the population drift towards urban areas and increase the economic and social divisions between rural and urban centres. Such divisions are already large; life expectancy in the National Capital District (NCD) in 1996 was 60.5 years relative to a national average of 54, domestic factor income per head was K6,091 in the NCD compared with the national average of K994, and all other human development indicators were better in the NCD (National Planning Office 1999).

Over the last 20 years, there has been a tendency for the quality and cost of services provided by statutory bodies in Papua New Guinea to deteriorate. Telephone services are frequently cut, aircraft services run hours late, electricity is frequently blacked out and voltages vary dangerously. The cost of

electricity is high by international standards (Duncan and Lawson 1997). There are a number of reasons for this, but the most important by far has been the politicisation of management of these organisations at board and management levels.

Appointment to boards has become a political reward, whenever governments and ministers change, most of the boards of directors of statutory bodies also change. The new appointees have no experience of the activity that they are to oversee, they generally have no business experience (or have experience of failed businesses), and some are even unable to read. Because governments change so often, and ministers even more often, the appointees are seldom left on a board for longer than one year and, therefore, have no chance to develop a knowledge of the workings of the organisation.

Remuneration packages for boards have become excessive by any comparison.¹² Chairpersons have almost all become 'executive chairpersons'¹³, which basically means that they pay themselves hundreds of thousands of kina in salaries and allowances, and are issued with the latest four wheel drive vehicles.¹⁴ The same applies to management teams of very technical organisations, which are changed almost every time a minister changes, generally from outside the organisation and often with no previous experience of that organisation or even that industry.¹⁵ It has been estimated that the cost of paying out the head of a statutory authority on dismissal is K900,000 on average, and dismissals have happened regularly during the life of the past governments with their many ministerial changes. It is no wonder that the positions are seen as lucrative and attractive spoils of war.

Not content with these salaries and conditions, many politicians and their appointees also see the operation of statutory institutions as their personal fiefdoms to be



exploited to the utmost. Not only do they not know how to run the business, they often do not care, preferring to travel incessantly around the world making bad business decisions and deals which often only benefit them personally. This has affected the staff and professional skills of these organisations.

The main argument for privatisation is that this culture of corruption has become so endemic that only a fully private entity responsible to shareholders and subject to competition will ensure that the goals of efficiency and good management are achieved. It is equally arguable, however, that corporatisation of the particular entity would make it subject to provisions of the Companies Act, thus forcing directors and management to take a more responsible attitude because there are prescribed penalties for failure to manage a company properly.¹⁶

To ensure that privatised companies continue to provide services without increasing prices, the government may have to put conditions on the sale.¹⁷ This will inevitably lessen the value of the entity unless the government is prepared to guarantee the service provider that it will make up the difference between the cost of providing the service and some controlled sale price. This should be done in the form of an explicit subsidy that is detailed in the budget every year.

The problem is that the introduction of a subsidy immediately reduces the pressure on the private company to produce at its most efficient level. Often companies will allow inefficiencies to creep into their management because they can be hidden in the subsidy. Unscrupulous operators will deliberately load additional costs onto their prices. It then becomes difficult for the government to distinguish between legitimate subsidy claims and spurious ones. The advantages of privatisation are reduced because the market is not fully operational and bureaucrats are again involved in pricing

decisions, just as they were under government ownership.

This is the greatest danger of the privatisation process in Papua New Guinea. Recent experience has shown that bureaucrats are ill-equipped to make decisions about pricing and, therefore, resource allocation (INA Forum, *Post Courier*, 29 September 2000). The Price Controller has created a controversy about allowing price increases for fuel and other items and, after extreme pressure from suppliers, has had to acknowledge that rises in international oil prices have to be passed on if supplies are to be maintained. Any system of control will be cumbersome, slow to react, and open to corruption.

Questions about rates of return, profit levels, and measures of efficiency will all have to be addressed by the government, if subsidised services are to be maintained. There are no hard and fast rules, and the government must carefully design a mechanism that can provide an overall improvement in efficiency at price levels that will also ensure services continue to be provided to rural areas. The Australian experience, where rural subscribers suffer a real or perceived disadvantage in telecommunications services, is a good example, and the provision of services there is cheaper and much easier than in Papua New Guinea.¹⁸

There is little to be said about the fact that the revenue gains from asset sales can assist governments to reduce debt and free up resources for more important needs. In Papua New Guinea, the Prime Minister has pledged that the gains from privatisation will all be used to reduce domestic debt, which will make funds available for development expenditure. He has also pledged that the process of privatisation will be open and transparent.

This means that entities will be offered for sale on the open market and sold to the highest bidder. It also means that PNG citizens will be offered shares in some of them



through the Port Moresby Stock Exchange. It is very important that the process is open and carried out in a competitive manner. Experience has shown that many countries do not do it this way and businesses or services are sold off too cheaply to a very small sector of the community who become very rich as a result. This has been particularly problematic in the former Soviet Union. We have had one experience in Papua New Guinea where government-owned shares were sold privately at what is believed to have been less than market value.¹⁹ The only way to ensure that the best price is achieved is for the sale to be completely open to any possible bidder.

As stated above, it is unlikely that the government will be able to achieve the expected value of K1.5 billion for the sale of its assets. Some of the entities, such as the Finance Pacific Group (formerly Papua New Guinea Banking Corporation (PNGBC)),²⁰ have profitable arms, but also have arms that will never, and should never try to, be profitable, such as the Rural Development Bank (RDB). The government will have to decide whether it wants to dispose of the RDB or what form of corporate structure it will have after privatisation of the Finance Pacific Group. There is still a need for cheap finance that can be accessed by small farmers and entrepreneurs for developmental expenditure and a number of micro-credit and micro-finance schemes are proposed to overcome this problem, and the concept of a development bank is still actively promoted.

The Finance Pacific Group provides nearly all of the passbook services in the country. As such, it has a virtual monopoly over retail banking at the smaller end of the market. Nevertheless, the service it provides leaves a lot to be desired. One only has to observe the long queues outside many of their branches on most days of the week to see that there is room for improvement. A privatised bank will be looking to cut costs further and therefore reduce services further

unless it is able to introduce new technology and banking practices that reduce costs. In the short term, the problems with the service levels of other statutory providers of utilities will make this very much harder.

Others, such as some of the telecommunications companies and Air Niugini, control licenses and routes that have commercial value and are attractive to outsiders. The value of these licenses will have to offset accumulated losses and outstanding loans to have any positive commercial value. Most of them are presently in serious financial trouble as a result of bad management combined with the government's failure to give them an adequate capital base.

In these circumstances, the privatisation exercise will be difficult and will require a lot of expertise. The government has appointed a panel of international experts to advise it on the technical and policy aspects of privatisation. It has also announced that it plans to bring in experts from outside to take over management of each body and prepare it for privatisation. There will be a different team for each body, comprising a merchant banker, a commercial banker, and a consultant with technical skills in the area to be privatised. A private accounting and consultancy firm, KPMG, has already been appointed to start sorting out the affairs of the Finance Pacific Group.

Advisors to the Privatisation Commission have been appointed to make recommendations on the very complex issue of community service obligations. Decisions that will have to be made include pricing, subsidies, quality of service, technical standards, and how the government will continue to monitor the entity. All of these issues will directly impact on the value of the organisation.

One area where privatisation could provide an impetus is innovation. When the PNGBC started looking at privatisation, it was visited by representatives of an



Australian bank that specialises in franchising, which could be a future direction for banking in Papua New Guinea. Under franchise arrangements, banking services would be provided by a number of small retailers using a major brand name. At least one senior banker in Papua New Guinea believes that this could be a solution. Electronic banking is a long way away from covering the whole of Papua New Guinea, but it will gradually be introduced as facilities become available.

Professor Helen Hughes cites advances in the telecommunications industry, which will make cables obsolete and allow much cheaper telephone connections (Hughes 2000). Advances in satellite technology will mean that Papua New Guinea no longer has to rely on repeater stations with the attendant land and vandalism problems. A more reliable telephone carrier will enable the expansion of electronic trading and banking services.

The PNG Trade Union Congress has expressed opposition to the whole process of privatisation (Paska 2000). It has questioned whether the claimed long-term benefit to Papua New Guinea will eventuate. It also raises the very strong view that these assets belong to the people of Papua New Guinea and should not be passed into the hands of private individuals. This is a strong emotional argument held by many Papua New Guineans, who basically see themselves already owning these assets through the state and distrust the transfer of ownership to private hands (*Transparency International (PNG) Newsletter*, April 2000).

The trade union movement has demanded assurances that services will continue to be provided at reasonable prices and that the government will ensure that employment levels and conditions do not fall. The government is yet to convince people that the process will not make them worse off and will not be beneficial only to a few rich individuals or companies.

The question of employment is difficult. It is almost certain that, when entities such as Air Niugini or Telikom are fully privatised, some jobs will be lost. Those in favour of privatisation argue that the overall effect would be an increase in employment. They believe that new private industries will be so much more efficient that they will be able to expand, providing incentives for new investment and new jobs. The provision of cheaper and more reliable services is also likely to encourage investment in other sectors of the economy.

The unions doubt this and point to deregulation of the labour market, which was supposed to lead to an increase in employment. They point out that the workforce has shrunk since the 1992 Minimum Wages case which deregulated wages and introduced one minimum wage which was less than half of the urban minimum wage at the time.²¹ One of the reasons given by employers arguing for this deregulation was that any increase in wages would result in a fall in employment.

Unfortunately, there are a number of reasons for the decline in employment, and it is not possible to isolate any one cause. The recent riots in Seattle and at the World Economic Forum in Melbourne are international examples of the fear and anger people hold about privatisation and globalisation, which they see as concentrating power and influence in an ever-decreasing number of hands.

This has been translated in Papua New Guinea to an Anti Privatisation Alliance of 'NGOs, unions, churches, students, women, grassroots, intellectuals, politicians and prominent citizens' (*PNG Independent*, 14 September 2000), which has organised a seminar and continues to threaten marches and other sanctions to prevent privatisation. The concerns seem to result from a lack of understanding and a lack of government information about the process. The emotional argument often portrays the process as being



Table 1 Readers' level of concern about privatisation (percentage of readers)

	Not concerned			Very concerned	
	1	2	3	4	5
Services in rural areas	16.2	3.6	6.3	5.9	68.0
Final ownership	16.4	7.0	17.8	10.7	48.1
Use of funds raised	12.2	6.1	12.2	15.5	54.0
Lack of competition	23.9	8.9	16.9	16.4	33.8
Government interference	18.5	7.4	18.5	13.0	42.6

Source: *Post Courier*, 14 September 2000.

an essential part of the World Bank and IMF conditions for assistance and follows the international 'activist' line that anything involving those organisations is automatically bad (*PNG Independent*, 14 September 2000).

Responses to a survey conducted by the *Post Courier* newspaper on the subject showed that readers were concerned about services in rural areas, eventual ownership of the entities, and where the revenues will end up. Readers cited the recent experience of the National Gaming Board, where more than K10 million has apparently disappeared without trace (Table 1).

There is no good reason why the rest of the community should have to pay higher prices for essential services like transport, telephones, banking and electricity, because these services support a larger workforce than necessary. That these organisations have been allowed to employ more people than they need is an example of the poor management that is one of the strongest arguments for privatisation. Unfortunately, this seems to be the case in most statutory organisations in Papua New Guinea.

At the same time, it is important to recognise that some services that have been corporatised are not suitable for complete privatisation, such as some of the agricultural research institutes, and a decision must be made as to the correct mix of government and

private funding for these organisations. These institutes undertake essential research that is high risk, but can also have high rewards; they cannot be expected to run on a purely private basis, although it is reasonable to expect that private beneficiaries will contribute where they can. The government should be prepared to guarantee their funding over rolling periods of at least five years because of the long-term nature of this sort of investment and the social benefits it can generate.

If government does recognise the need for these organisations to remain in public hands, it must reform the management of them. Boards of directors should be subject to the Companies Act and liable for prosecution if they mismanage these institutes. Members, moreover, should be appointed on the basis of their potential contribution rather than their political persuasion.

Performance

In the Finance Pacific Group, overall progress has been slow. Failure to appoint the Chief Executive for several months meant that there were delays. Soon after Sir Henry ToRobert was eventually appointed he became very ill, and Mr Joe Tauvasa was then appointed to act in his stead. Key issues have not been



openly debated and there is a natural resistance to the process from some of the people who are afraid of losing their jobs. A recent attempt by the management of Finance Pacific Group to pay themselves out for a total sum in the vicinity of K9 million did nothing to improve confidence in the process.

The government intends to privatise the Finance Pacific Group at the very least by March 2001. Privatisation will have two stages. First, there will be a trade sale of 51 per cent to an existing domestic or foreign bank to ensure that banking expertise is guaranteed. The remaining 49 per cent is expected to be sold by share issue on the Port Moresby Stock Exchange (POMSOX) about 1.5–2 years later.

The government and the Privatisation Commission have not made public the exact mechanism for the public issue, and outstanding issues revolve around whether unit trusts will be set up and whether or not the issue will be restricted to citizens of Papua New Guinea. These decisions are complicated by the need to comply with the listing requirements of POMSOX, which does not allow restrictions on the sale of shares (although a temporary exemption was made recently for a company that had restricted share ownership).²²

The government has been able to dispose of its shares in Halla Cement, a joint venture with the Halla Corporation of Korea. The government had shares in the company, whose major activity was grinding clinker cement, and had guaranteed its loans. Initially, the government asked KPMG to value the project, and a Japanese company made an offer of K8.5 million, which would have cleared the state debt but required the high levels of protection to continue. In the final deal, the company was sold for K4 million, and the state being was left with US\$4.5 million to repay from the original loans for the project.

The deal was not very open or transparent, and was handled by the state

rather than the Privatisation Commission, which was brought in to finalise the deal after agreements had been reached.

The Privatisation Commission has also advertised for legal assistance in the privatisation of Air Niugini. Currently, the airline has an excess of liabilities over assets of at least K20 million. It has not paid VAT or airport charges since 1999. It has some valuable international routes and landing rights which may be attractive to other regional airlines, particularly Singapore Airlines, and Qantas and Ansett from Australia.

Like the Finance Pacific Group, the aim is to sell shares in the company after a trade sale instates a reputable company in the manager position. The airline has run profitably in the past and could do so again. One issue that has to be addressed is the cost of airport services, especially after the Civil Aviation Authority has been corporatised and finishes its planned upgrading of airports around the country.

Opening the airways to competition will see a reduction in services by Air Niugini, which will most likely be compelled to reduce its services to ports that are profitable and leave the others to third-level carriers.

Transparency and accountability

The government has guaranteed that the whole process of privatisation will be open and transparent (Morauta 2000). Transparency International (PNG) and the INA held a forum in February 2000 in which ways of achieving this transparency were discussed. In particular, the Integrity Pact as implemented internationally by Transparency International was discussed (Wiehen 2000; Robledo 2000). This pact basically commits sellers and buyers to undertake in writing that no bribes will be offered or taken and that contracts can be made null and void if any corrupt practices are uncovered.



As a result of that workshop and the failure of Transparency International (PNG) to have this process effectively implemented at the National Capital Development Commission, it was decided to try and ensure that it was implemented from the outset of the privatisation process. Discussions have been held with the Privatisation Commission about the introduction of the Integrity Pact and an interest register. Transparency International (PNG) has secured enough resources to be able to provide an ongoing monitoring process as privatisation proceeds. The commission has accepted the process in principle but has not yet implemented it fully.

It was inevitable that the whole process of privatisation would attract a great deal of rumour and speculation. The common knowledge of corruption, and the involvement of some of the nation's leaders in shady deals, has meant that there is widespread scepticism about the process. It would be very much in the government's interests to ensure that all deals are completely transparent and that they get the imprimatur of a body like Transparency International (PNG).

Conclusion

A process of privatisation has started in Papua New Guinea and the present government has decided to make this one of its top priorities. It has two reasons for doing so: to raise revenue in order to retire existing debt, and because it sees the continuation of government ownership as an inefficient way of providing services. The sheer act of privatisation will not bring about all the things the government of Papua New Guinea wants to achieve.

Many of the utilities and services play an important part in human development opportunities and nation building which, for a variety of reasons, cannot be left to the

market to provide. The government must ensure that the services continue, and the best way that this can be achieved is through the provision of explicit subsidies. This will need careful thought and very careful guidelines to ensure that the subsidy is not providing excessive profits, but does cover the actual cost of providing the service. Decisions will have to be made about the prices that will be paid by consumers and how to measure the delivery to ensure that services are being provided efficiently.

The emotional issues of ownership will need to be addressed by ensuring maximum transparency in asset sales and by giving all Papua New Guineans an opportunity to participate in the process. Where services are fully privatised, checks will be necessary to ensure that monopoly profits are not earned due to the natural protection provided by the nature of the PNG market; that is, the fact that it is not big enough to sustain more than one provider.

Notes

- 1 For example, until recently the Rural Development Bank was subsidised by the government because it was expected to provide cheap development loans to small farmers and business people.
- 2 For example, the minor power house program in which the government supplied power to its outstations for a nominal charge.
- 3 The Oil Palm, Coffee, Cocoa and Coconut Research Institute and the National Agricultural Research Institute, among others.
- 4 The author was directly responsible for this review as the head of the Provincial and Statutory Institutions Division of the Department of Finance at the time.
- 5 Since the early 1990s, the PNG Growers Association and the Rural Industries Council have been urging the government to introduce a freight subsidy for agricultural produce. In 1990, the freight charge for transporting a bag of copra from Open Bay



to Rabaul was K2–2.50, it is now K12. It cost K14 to get copra from Tabar Island to Kavieng. Despite many promises, the government has failed to provide freight subsidies to these remote areas.

⁶ The sale was not done by public tender and it was strongly rumoured that there were other buyers who were prepared to pay more than the eventual sale price if it had gone to tender.

⁷ Response to a question at the 1999 Budget Lockup.

⁸ Although Telstra (Australia) has not been fully privatised, the introduction of competition through Optus and a variety of smaller specialist carriers has meant a wider range of services. It has also lowered the cost of telephone calls in money terms relative to ten years ago.

⁹ In 1983, the government directed CSAs that their primary objective was ‘...commercial return’ (Whitworth 1993:13), but this was never fully implemented.

¹⁰ A requirement to ensure that the privatised entity continues to provide services at reasonable rates to high-cost consumers. This policy aspect is the responsibility of the Treasury, which has a group of external advisors working on it.

¹¹ Air Niugini was allowed to introduce price increases in two staggered rises of 5 per cent, rather than a single increase of 10 per cent, primarily to protect consumers from market forces.

¹² The head of one statutory body was paid US\$400,000 per year, and the average package is around K500,000 per year, including allowances, housing and other items.

¹³ One of these was reliably reported to have been receiving more than K1 million per year for a three-day working week.

¹⁴ One chair of a particular statutory authority had two top-of-the-range four wheel drive vehicles purchased for him, with one stationed in Port Moresby and one in Lae.

¹⁵ In the last four years, there have been four different governors of the Bank of Papua New Guinea. The position is one of the most technically demanding and influential positions in the country, and in most countries is generally only occupied by

professionals with a lifetime of experience in economics or finance.

¹⁶ Penalties comprise fines of up to K200,000 and jail sentences of up to five years, see Institute of National Affairs and BCPNG (1997).

¹⁷ This may not be necessary if the purchaser is able to introduce new efficiencies or technology that lessen the cost of the service.

¹⁸ Part of the debate surrounding the full privatisation of Telstra is about the possibility of the privatised company reducing services to rural areas, and recent electoral setbacks in rural areas have made the government very sensitive to these claims.

¹⁹ The author had a conversation with a person who claimed to represent a buyer for the government’s shares in a recent sale, who was willing to pay considerably more than the shares were actually sold for.

²⁰ The Finance Pacific Group took over the Agriculture (now Rural Development) Bank, Motor Vehicles Insurance Trust and the Niugini Insurance Corporation.

²¹ See Paska (2000). Levantis (2000) shows that this is erroneous and that urban employment grew strongly during this period.

²² Personal communication, PNGSOX, October 2000.

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