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SPOTLIGHT

COMMUNITY SERVICE OBLIGATION IN PAPUA NEW GUINEA: THERE IS A NEED FOR POLICY ACTION

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Key Points

- In order to maintain the provision of essential goods and services to support social and economic development, most State-Owned Enterprises (SOEs) undertake community service obligation (CSO).
- The recently approved CSO Policy advocates for identification and financing of high costs and uneconomic provision of essential services by SOEs, which has the potential to explicitly define and capture the true costs of delivering the CSOs.
- Lack of implementation of the CSO Policy continues to undermine SOEs' ability to improve their performance and extend service coverages to rural areas.
- It is desirable to implement the CSO Policy to ensure CSOs delivery in a transparent, accountable and sustainable manner.

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By Ronald Sofe

State-owned enterprises (SOEs) in Papua New Guinea (PNG) play a vital role in the provision of essential services such as electricity, telecommunication and ports, which are required to support the economy and improve citizen's welfare. In order to maintain and expand access to these essential services throughout the country, majority of the SOEs are undertaking community service obligation (CSO). CSO refers to an arrangement where a government requires state entities or SOEs to undertake activities relating to the supply of goods and services that they would not choose to do on a commercial basis. In compliance with the requirement, the SOEs delivering essential goods and services must maintain a specific tariff structure to provide concessions to the end users. In other words, the fees collected by service providers do not cover the cost of provision.

Providing non-commercial services over a long period of time can have adverse impact on the profitability of the state businesses. There is growing concern that most of the SOEs in PNG are struggling to perform financially well and efficiently deliver essential services. This can be partly attributed to lack of clarity in the CSO process. In a recent review by the Asian Development Bank (2020) on underlying constraints behind failing commercial performance of SOEs in PNG, the Community Service Obligation Policy emerges as one of the supporting policies that is yet to be effectively implemented. It can be acknowledged that effective CSO Policy for managing CSOs is a critical component of SOE reform and delivery of essential services. This paper seeks to highlight key features of the CSO Policy and the implication on existing arrangement of CSOs delivery by the SOEs. It then calls for a renewed focus on implementation of the CSO Policy as a way forward.

Policy for non-commercial services

Having gone through a series of consultation with relevant stakeholders, a formal CSO Policy was approved by the Government of PNG (GoPNG) in 2013. The policy aims to improve the efficiency and transparency of CSO service delivery with positive impact on commercial performance of the SOEs.

To implement and give effect to the CSO Policy, the policy document notes that a legislation will be prepared to require all SOEs to operate on commercial terms to be a successful business similar to private businesses not owned by the State (Department of Treasury, 2012).

It states that when GoPNG directs an SOE to provide a CSO, the Government and the SOE will enter into a binding CSO contract that will specify the goods and services to be provided and the amount payable by the Government. It further states that no SOE shall provide a CSO unless it has been specifically directed to do so by the National Executive Council and subject to an agreement that has been documented in a CSO contract (Department of Treasury, 2012).

To assist in the implementation of the CSO Policy, a CSO guideline has also been developed to provide details on requirements for applying for a CSO. It requires a cost benefit analysis to be undertaken for the CSO. It also calls for proposals to show how the cost of the CSO will be reduced over time, and at the same time for performance monitoring arrangements to be in place. It was intended that the Kumul Consolidated Holdings (KCH), custodian and trustee of SOEs and state investments, would review CSO applications which would then be assessed by the Department of Treasury and Department of National Planning and Monitoring. The KCH would be required to maintain a register of CSOs that would be publicly available. The policy document specifically notes that the preferred funding method would be through the national budget but there is scope in the CSO Policy for the Government to decide on a different funding method (Department of Treasury, 2012).

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After the approval of the CSO Policy, the Government directed that it should be piloted in three selected SOEs, as a first step in implementation, and that CSO legislation be drafted to give effect to its implementation. PNG Power Limited (PPL), PNG Ports Corporation Limited (PNGPCL) and National Airports Corporation were selected and the process formally started in mid 2014 but got stalled along the way. It turned out, there were difficulties in garnering the needed support and commitment to drive the implementation.

Current application of CSO

Majority of the SOEs in PNG are mandated by legislative requirement and the Government to pursue certain CSOs which require in most cases, delivery of services to high supply costs and unprofitable areas. To date, various SOEs in PNG have in effect delivered CSOs by cross subsidies in their commercial activities through uniform pricing (Fallon, 2017).

Under uniform pricing arrangement, same tariff is applied across the country irrespective of high costs and uneconomic return for provision of a particular service. In that way, the users and communities consuming that service are not disadvantaged compared to those who can afford and generate economic return.

For example, PNGPCL maintains and operates several unprofitable ports in the country as part of its requirement under the existing CSO arrangement. According to APEC Secretariat (2017), the profitable port of Lae, Port Moresby and Kimbe currently cross subsidise a number of loss making ports throughout the country. PNGPCL, through its port network, provides berth and handles containerised and breakbulk cargo as well as other essential ports services. These are essential services needed for the country's trade and economic activities. As a SOE, it is expected to pay a dividend to the Government, but at the same time provide CSOs set by the Government and operate within the price path and service standards set by the Independent Consumer and Competition Commission (ICCC) for essential port services.

Another case in point for current CSO application can be found in the generation and supplying of electricity. Electricity is a critical catalyst for social and economic development and therefore, ought to be penetrated widely throughout the entire landmass of the country. Through application of uniform pricing, PNG Power Limited (PPL) subsidises electricity prices in its loss-making centres with revenues from profitable operations. According to ICCC (2013), PPL provides electricity to the local communities in 14 regional centres on a non-commercial basis at the national uniform retail tariff. Consistent with the SOE requirement, PPL is obligated to provide services to both commercial and loss-making centres within the parameters of pricing pathway under a regulatory contract with ICCC.

Assessment of CSO arrangments

There is a general consensus that the current CSO arrangements undertaken through cross-subsidisation, undermine SOEs' performance. Fallon (2017) states that it is not cost reflective with higher density urban centres in effect cross subsidising lower density areas. According to ADB (2020), the existing CSO arrangements are criticised for providing weak incentives for service provision in high cost areas, preventing more efficient providers from entering the market, and undermining SOEs' focus on commercial performance. APEC Secretariat (2017), in assessing impact of the CSO obligations on PNGPCL's operational efficiency and pricing, noted that the significant cross-subsidies were compromising the effectiveness of PNGPCL's business. It is noted that uniform electricity tariff undermines expansion of electricity to rural areas and affects PPL's commercial performance (ICCC, 2013).

These concerns highlight the fact that there is no clear rules or processes that guide delivery of CSOs in terms of how the CSO services are identified, documented, costed and monitored. In the absence of implementation of the CSO Policy, there is grey area on what constitutes CSOs, the real costs of delivering the CSO services, the effectiveness, and the accountability and transparency in funding them.

Considering these setbacks, the formulation and approval of the CSO Policy is timely. An optimum result from its implementation would be one that ends cross-subsidisation and brings forth positive impact on SOEs performance. However, one fundamental factor that can trouble prospect of CSO Policy is the inherent constraint to collect adequate revenue when capacity to pay for services is limited. This would mean that SOEs are unlikely to be able to fund or receive adequate subsidies to fund network expansion required for widening access to essential services. This issue explains the tendency to fall back on uniform pricing as the default action to finance some limited cross subsidies. The problem is essentially the conflict between the cost of expanding access and the capacity of the community to pay for access. This is compounded by the ongoing problem of Government to raise public finance. Government borrowing capacity is highly constrained and raising taxation revenue is a longstanding fundamental problem.

Options to resource implementation of CSO Policy

One way to help address the financing constraint is to encourage private sector investment through Public Private Partnerships. Private sector is known to possess capital and necessary resources but the regulation of uniform tariff has to cease as it discourages investments that seek to offer services on commercially sound terms to generate return. To supplement this, partnership or concessional funding from multilateral and bilateral donors is likely to be needed to ensure success in meeting SOEs and related Government policy objectives. For example, the PNG Electrification Partnership reached by Australia, the United States, New Zealand and Japan, may assist PPL in its CSO operations, in particular in the drive to advance rural electrification. However, in any case, there has to be a strong and credible commitment by the government to take lead in coordinating and pooling of necessary funds for CSO undertakings. It is commendable to note that the Government has recently initiated the SOE Reform Program with the support from the Asian Development Bank, which among other reform agendas, requires prospective CSOs to be distinctly identified and costed.

In so far as effective implementation of the CSO Policy is concerned, an amendment of relevant sections of the Kumul Consolidated Holdings Limited Act 2015 to accommodate provisions for CSO application, or the introduction of CSO legislation is necessary. To achieve it, the requirement that all SOEs operate as successful businesses must be sternly reinforced.

Concluding remarks

Majority of SOEs undertake community service obligations in order to maintain and expand provision of essential goods and services such as electricity, water and ports which are necessary to support social and economic development. The CSOs have been delivered without clear rules in terms of how the services are identified, documented, costed and monitored. SOEs have in effect delivered CSOs by cross subsidies in their commercial activities through uniform pricing. CSO Policy provides a framework for identifying and financing high costs and non-commercial services by SOEs, rather than the current practice of cross-subsidisation. The key principle underpinning the CSO Policy is that SOEs should operate commercially, and competently expand services throughout the nation. Therefore, the need to effectively action the CSO Policy is pressing now.

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