Spotlight with NRI

Development Issues, Policies, and Trends

February 2012 **Vol. 6 No.1**

CREATION OF MONOPOLY IN RICE INDUSTRY DETRIMENTAL TO PEOPLES' OVERALL WELFARE

Modowa Gumoi and Logea Nao

Introduction

The National Research Institute (NRI) has been watching with great interest, the recent debate surrounding the looming possibility of a monopoly in Papua New Guinea's (PNG) rice industry.

Evidently, opposing views have been expressed. The rice industry, particularly Trukai Industries Limited, the business sector, the general public and the Independent Consumer and Competition Commission (ICCC) oppose the proposal. Cabinet, it seems, is divided over the issue.

The NRI is of the view that the creation of a monopoly in the rice industry would be detrimental to the overall welfare of the people. This is because the costs of the monopoly far outweigh its benefits.

The NRI instead, propagates for continued competition as it did for the mobile phone market, which saw the introduction of Digicel to compete with Bemobile, and similarly, for the aviation industry, opposing the code share arrangements between Air Niugini and Qantas.

The benefits of these competitive arrangements are now enjoyed by the public in the form of lower prices, better services and product variety.

Looking back, Trukai Industries used to monopolise the rice industry in PNG. The NRI has argued against such an arrangement and supports competition in the industry. PNG now has a competitive rice industry with several competitors, with Trukai, nevertheless, commanding a larger market share.

Why do we want to go back to the original situation and discard the benefits of competition?

Have we not learnt from the failed InterOil, Ramu Sugar and Halla Cement agreements?

InterOil Corporation was granted exclusive rights by the government to be the sole producer and distributor of petroleum products that squeezed its competitors, Shell and BP out of the market. However, InterOil did not build a refinery as it had originally planned to do.

Ramu Sugar was granted protection by the government in the form of import embargoes on CSR (Colonial Sugar Refining) sugar imports, favourable tariffs and tax breaks until 2011 when tariffs were reduced to cater for imports due to underproduction. This, high prices, and concerns over quality, are issues that sugar consumers have had to contend with.

The country's only cement company based in Lae, Halla Cement, was also afforded protection by the government. However, a civil unrest at the end of 2011 led to cessation of cement production which affected the building industry and overseas export contractual obligations.

No doubt, the proposal by Naima Agro Industries for exclusive monopoly rights for the production, import and distribution of rice in PNG has again brought to the forefront, the debate between monopolies and competition.

Aside from natural monopolies, which can be justifiable, created (protectionist) monopolies, as is now the case, are generally considered to be detrimental to overall welfare in the form of high product prices, lower and inefficient production, low rewards for factors of production rendered, low quality of output, limited number of products available to consumers, and decline in food security.

Moreover, if the created monopoly company is foreign owned, then profiteering and transfer pricing are a case for concern. These defects, inherent in created monopolies, have many governments the world over (e.g. Australia and New Zealand) favouring and adopting competition in just about all sectors of the economy. An exception would however be socialist planned economies.

Competition is generally considered to be welfare enhancing as it encourages a level playing field and in most cases, ensures competitive pricing, efficient production, fair rewards to factors of production, quality output and a wider range of products. A competitive environment induces innovation as a survival strategy which benefits both the firm and the consumer.

Background

Naima Agro Industries, a company owned by a sole trader of Indonesian origin is seeking exclusive monopoly rights for the production, import and distribution of rice in PNG. The project developer has asked the Government of Papua New Guinea (GoPNG) to give the company 20 years to operate as a monopoly in the rice industry. The K5 billion commercial rice farming project is proposed to be developed in the Kairuku-Hiri District, Central Province, covering some 100,000 hectares under the Special Agriculture Business Lease (SABL) arrangement and possibly as a clear fell operation in the initial stages.

Currently, the GoPNG, through a state team consisting of key government departments and agencies, is in negotiations with the landowners of the proposed project site. They have been discussing the project agreement as well as issues relating to the establishment of the project. A Deed of Agreement (second draft) between Naima Agro Industries and the GoPNG is now being scrutinised.

The GoPNG is understood to have a view that the proposed project is a major impact agriculture project. Upon operation, the project would generate long term benefits for the country. This would come in the form of much needed development to the struggling agriculture industry, employment creation, income generation, development of the local economy and communities.

The project is seen to meet the government's objectives of rice self-sufficiency (i.e. import substitution through local commercial rice production) and food security. Objections however, have been raised by members of the public who fear that such a venture may be detrimental to the rice-loving consumers of PNG. The varying views expressed by government ministers, the business community and the public are indicative of such objections.

Industry Overview

Rice is a major consumer item which is always present in the meals of most PNG families, particularly in the urban areas. Although substitutes such as taro and yam are readily available in rural areas and flour-based substitutes like bread and noodles in the urban areas, rice has become such a large part of the diet for many PNG households that it cannot be easily replaced and its importance cannot be watered down.

There are many players in the rice industry including importers, growers, processors, wholesalers, retailers, and consumers. They dictate the nature of the industry in PNG. The industry therefore consists of and is affected by local and international interests in terms of pricing and production levels.

Trukai Industries has been, and remains, a dominant player in the rice industry. This is indicated by the popularity of its brand products – Trukai Rice and Roots Rice. However, several companies such as Homestate Corporation Limited, Associated Mills Limited, National Rice Distributors and Lam's Trading have been able to successfully enter the industry and provide alternatives to the traditional brand. This has resulted in increased varieties of rice, and more recently, a reduction in the price of the traditional rice brand (Trukai rice products) by 18 percent.

Issues Surrounding the Proposal

The proposed rice monopoly is outright anti-competition and contravenes the *ICCC Act* 2002, which propagates competition and fair trading. Only through competition can such concerns as fair pricing, efficiency in the production of goods (rice) and improved consumer benefits, be achieved. Sure enough, there will be benefits obtained by the local communities and landowners of the project area in increased job prospects and development of the local economy, but this will come about at the expense of the general public who will have to dig deeper into their pockets to buy a packet of rice.

PNG has experienced firsthand, the benefits of competition in the mobile phone industry and the airline industry. Is the country prepared to allow a single company seeking exclusive operational rights to do away with a competitive environment with fair and reasonable pricing practices?

The proposal by the project developer seeks several exclusive rights with the GoPNG and is quite absurd. These include:

- duty free import of capital equipment and all imports for the operation of the project;
- tax breaks and concessions for their company tax;
- no taxes on dividends paid by Naima to its shareholders;
- zero income taxes for company employees earning up to K360,000 per annum;
- imposition of 60–80% import tariffs, and
- compensation by GoPNG should it breach any of its exclusive arrangements.

Although this can be considered an incentive for foreign investment, it should be noted that this project is a big ask to the people in terms of land use, economic concessions and incoming labour mobility. The people of this country have a right to dictate terms and conditions of the project as well.

All specifications of the proposal by the developer should be thoroughly screened by independent qualified experts (aside from the team appointed by GoPNG) through a detailed cost-benefit assessment. This is not only to determine the project viability but also the opportunity costs involved. Wider public and landowner consultation should be encouraged.

The State team needs to be impartial in its deliberations with the landowners and the landowners need to exercise caution during negotiations to ensure they get value for their land. Principally, all PNG parties involved in the project should uphold the interest of consumers at heart, throughout the negotiation process and ultimately in influencing an outcome for their benefit.

The imposition of import tariffs contradicts the government's tariff reduction program. Such a program is a result of the government's international commitments to the World Trade Organisation (WTO) on trade liberalisation and the Asia-Pacific Economic Cooperation (APEC). Any breach of these international commitments will be damaging to the country.

The proposed monopoly will prove detrimental to existing market players who have been loyal to the country for years. The existing rice market players, particularly the small enterprises have entered the rice market through the normal process and have built up their business reputation by competing with one major company, Trukai Industries.

This has enabled the existing market players to meet the consumer demand for rice on a level playing field, ensuring efficiency in the production of rice, and competitive and fair pricing. This has also helped many families and collectively contributed to improved food security in the country.

It is rather baffling that Naima Agro Industries is seeking exclusive preferential treatment under the pretext of the 'infant industry argument' when it is free to enter the rice industry through the normal competitive process and under current market conditions. Is it that it has serious defects as a company and producer of rice? An audit of the company is also warranted.

Conclusion

The current competitive markets in the rice industry in PNG have proven to be of public benefit. The proposed rice monopoly by Naima Agro Industries has the potential of undoing the benefits of competition in the form of reasonable prices, efficiency in the production of rice, variety of rice products and food security, currently enjoyed by the general public.

About the Authors

Dr. Modowa Gumoi is Senior Research Fellow at the National Research Institute.
Ms. Logea Nao is Project Officer in the Economic Policy Research Program at the National Research Institute.

Contributions to Spotlight should be addressed to the Director, NRI:

Fax: 326 0213
Email: nri@nri.org.pg
Post: P.O Box 5854, Boroko. NCD 111. Papua New Guinea

Further information on the National Research Institute can be obtained from the Institute's website—www.nri.org.pg