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PRIVATISATION IN PAPUA NEW GUINEA

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INTRODUCTION

Privatisation is the transfer of ownership of assets from public to private entities and the transfer of provision or delivery of services from the public sector to the private sector. Privatisation as a policy and ticket item started in the United Kingdom under Prime Minister Thatcher and has gained worldwide momentum as the alternatives of 'statism' — involving publicisation or state ownership of commercial enterprises — which is seen to have failed, as is evident from economic stagnation and the collapse of Communism in the Eastern European countries. Attendant to this, 'the literature in development economics has now turned full circle from the unquestioning dirigism of the early minimalist role for the State' (Bardhan 1990:3). This global movement towards privatisation has now come to Papua New Guinea, as the nation's economy has stalled particularly with the emergence of the Bougainville crisis, which forced the closure of the high revenue-generating Bougainville copper mine.

Public sector supply arrangements can involve direct production by the State or alternatively it can mean the use of the private sector to achieve the same ends. In practice, it has involved a combination of the two. There are at least three arguments in support of public sector involvement (that is, publicisation as against privatisation) in the ownership and production of goods and services. These arguments are based on the concepts of *natural monopoly, external economies* and *nationalism.*

In most countries, postal services, telecommunications, electricity and water supply are owned by the State. Also, railways and airlines, where they operate, are generally owned by the State (Trebilock 1983: Table 1; and *The Economist*, 30 December 1978), although the private sector is allowed to compete in these two areas. The economic argument which has led to the production and supply of the former services by the State is based on the concept of natural monopoly. A natural monopoly is an extreme case of economies of scale, under which unit costs of production continue to decline with increases in output. The consequence of this is that a single firm is able to produce the output at a lower cost than two or more firms. However, as is clear from the experience of the United States of America, it is not necessary for the State to be involved in the production of such services.

The State has the option of allowing a private sector monopoly to produce such an output. However, given the deviation between price and marginal cost, which natural monopoly imposes, government regulation of natural monopoly is necessitated if the output is produced by the private sector. With technological changes and changes in economic fashion, the concept of natural monopoly has come to assume a much narrower focus. It is accepted that it is cheaper to have a single grid; that is, to have a single set of wires for electricity and telecommunications and to have a single set of pipes for gas and water. However, it is increasingly being argued that there is no particular reason why only one firm should be involved in the production of the output of any of these services, although one firm should be involved in its distribution.

The argument against the State being involved in the production of the output of natural monopolies is that there can be a conflict between the State as

the producer and the State as the regulator. Against this, there is the added cost of regulation, which arises where the State is dependent on information from the private sector. In less developed countries (that is, countries where the living standards are regarded by the people of these countries as well as the rest of the world as unacceptably deficient), such regulatory capacity is likely to be weak. In addition, given the weakness of the national capitalist class or bourgeoisie, such natural monopolies 'if left to the private sector' are likely to be run by foreign enterprises. This is unacceptable to most governments.

Also, there is the issue of cross-subsidisation under which the more remote areas and similar urban centres (where marginal costs of such services are higher) are charged less than the marginal cost of providing such services, while the larger urban areas are charged above marginal cost. As such, cross-subsidisation is a social objective — a 'community service obligation' — and it is better handled through the State's budget as an explicit subsidy to the producer. This is because cross-subsidisation leads to a shift away from the allocative efficiency objective of equalising price and marginal cost. However, this is not an argument for privatisation. It simply provides a clearer definition of the objectives.

In addition to the natural monopolies in the outputs — of which the State in most countries is involved — the State in less developed countries has also become involved in the ownership and production of other outputs and supply of services. The main economic rationalisation for this involvement has been provided by the application of external economies (Agarwala and Singh 1963). External economies (benefits as against costs in this case) arise when the *social* benefits of an activity exceed its *private* benefits. This may happen because an expansion in capacity lowers prices for other firms. An individual firm is unable to internalise such benefits and therefore, underinvests in such activities.

This argument is reinforced in the economies of less developed countries through the recognition that markets are weak and external economies are therefore more widespread. It is explained by showing how an expansion in capacity in one large firm can lower prices to firms who require such outputs as inputs and how, by increasing demand, the prices for the outputs of other firms are raised. Such interdependence and complimentarity are seen to be more widespread in less developed countries. As the economy expands, it creates a pool of skilled labour, which was previously not in existence. Consequently, the State is seen as having a role in stimulating private investment through a public investment programme. However, this position assumes that there are surplus savings in the economy or available from the rest of the world, which the economy is unable to utilise without State involvement. Often, the problem is excessive government consumption, which reduces the savings available to both the private and public sectors for investment.

Foreign ownership of assets is often seen to be undesirable from a nationalistic point of view. The economic case against foreign as opposed to local ownership, whether through the State or national capitalists, forcibly buying into such assets, or through the restriction of foreign investment to specified activities has not been successfully established in economic literature. Nevertheless, it is in the interests of national capitalists who wish to create economic space for themselves and economic bureaucrats who benefit from state

ownership, to limit foreign investment. In a number of less developed countries, the national capitalists are weak and, therefore, the State is seen as the protector of the national interest. Also, foreign multinational companies are seen to have the ability to transfer price (through underinvoicing exports and overinvoicing imports) and to extract excessive surpluses from such countries. In addition, the influence that multinational companies wield on the polity of any small economy is seen to be unacceptable.

These factors have led to an enlarged ownership and production role for the State in Papua New Guinea. However, as the economy has faltered, there is increased argument that the State should reduce its role. The push for privatisation has to be seen in this light, although it is buttressed by the arguments for micro-economic reforms, which require an increase in productivity and an improved return from public sector investment. Given that there is an opportunity cost of such investment, where such a return cannot be boosted in the public sector, the argument for privatisation becomes stronger.

The arguments against publicisation and in favour of privatisation are tied to the assumption that the government business enterprises, unlike their private sector counterparts, are not subject to market discipline. For example, 'government business cannot go broke' and because the managers do not own shares in the enterprise, they have no personal stimulus to protect their own financial interests.

As in the case of other countries, Papua New Guinea has moved to corporatise and commercialise some of the larger public sector enterprises which are regarded as natural monopolies. Where they are commercialised they compete on the same basis as private sector firms; that is, they are required to pay the same indirect and direct taxes. Corporatisation involves the creation of agreed corporate objectives and the means of achieving such objectives, and can be with or without commercialisation, or vice versa. However, where the public sector firms have been commercialised and corporatised, the arguments for privatisation are more limited to those of lifting 'x' efficiency; that is, to reducing laxness in management and reducing 'featherbedding'. However, it is also possible that similar laxness and featherbedding exist in large and poorly managed private sector enterprises.

It is unclear whether or not there are advantages in turning public sector monopolies into private sector ones. In addition, there are constraints which limit the scope for privatisation in Papua New Guinea. The tussle between the proponents of privatisation and publicisation continues in Papua New Guinea. However, we believe that privatisation/publicisation will make only a marginal difference to Papua New Guinea's economic performance. The major constraints to the nation's improved performance are:

- the relatively low level of savings;
- the low capital efficiency of capital whether in the private sector or public sector;
- the short working year; and
- the slow improvements in nutrition, health and education.

The improvements in the latter three components firmly influence the improvements in human resources.

NATIONAL OWNERSHIP IN PAPUA NEW GUINEA

There has been a steady increase in Papua New Guinea in public ownership and shareholding of private sector enterprises; that is, of publicisation, since the early 1960s. Such publicisation, prior to independence, was partly because there was virtually no indigenous private sector which might have occupied the economic space rendered by these enterprises. It is important to note that most of these enterprises were set up by the Australian colonial administration and were continued by the Somare national government which was formed in 1972. However, there was some extension of publicisation in the post-colonial period.

Not all of the enterprises in which the State has a shareholding can be regarded as public sector commercial enterprises — enterprises which are 'government-owned and/or controlled' and 'which sell industrial goods and services to the public' (Floyd 1979:6)

In the 1960s and 1970s, the increasing share of foreign ownership and control and the absence of a national capitalist class or national bourgeoisie led the State to assume ownership of a number of enterprises which would normally be provided by the private sector. Almost two-thirds of the market Gross Domestic Product was seen to accrue to non-nationals in 1971. The commercial banking sector was not responsive to the needs of Nationals, therefore, the Somare government introduced a number of policies to further the first of the eight aims (enunciated towards the end of 1972):

> A rapid increase in the proportion of the economy under the control of Papua New Guineans, individuals and groups and in the proportion of personal and property income that goes to Papua New Guineans.

Essentially the policies in this respect were two-pronged. The first policy involved creating a financial sector which would respond to the needs of an independent Papua New Guinea and to the aspirations of Papua New Guineans to acquire an increasing proportion of the assets located in the country. This was done through the establishment of a Central Bank (Bank of Papua New Guinea), and the transfer of the Commonwealth Bank of Australia as the Papua New Guinea Banking Corporation (PNGBC), into Papua New Guinean public sector ownership. Steadily through the credit guarantee scheme, under which the State assumed eighty percent of the risk of lending to Papua New Guinean businesses and through a steady shift — by moral suasion — in the volume of commercial bank lending to Nationals, the proportion of assets owned by Papua New Guineans has been increased. From a situation in the early 1970s when some ten percent of the commercial bank lending was allocated to Nationals, by 1990, around sixty percent of such lending was made available to them.

The second policy involved the State acquiring assets in existing businesses, establishing commercial enterprises in partnership with foreign firms, and/or setting up wholly owned public sector commercial enterprises. The Investment Corporation of Papua New Guinea was initially set up in 1971 to acquire minority shares in established foreign-owned companies. Subsequent to this, its role was extended to initiating new projects and to acquiring majority shareholdings. By 1981, it was operating eight companies with a total investment of K9.3 million (Trebilock 1983:145). Most of the companies were reasonably profitable then — the most profitable being Angco Pty. Ltd., which was involved in the exporting of coffee and cocoa and in plantation management (ibid.). Although the Papua New Guinea Development Bank (subsequently, the Agricultural Bank of Papua New Guinea) was established in 1967 with the intention of promoting Papua New Guinean businesses, it also ended up owning and managing projects such as Niugini Tablebirds (ibid.:135-136). It was also successful in placing a number of Papua New Guineans into retail trading through the Stret Pasin Stoa Scheme. The Agricultural Bank's objective remains the sale of its assets to Nationals. Therefore, it remains a vehicle for extending the national bourgeoisie. However, in the 1990-1992 period, it was faced with a liquidity and financial crisis as low agricultural prices and the recession in Papua New Guinea, in the aftermath of the Bougainville crisis, hit the businesses to which it had lent funds.

The major fully and partly owned state enterprises are listed in Table 1 in order of the size of fixed assets.

As Table 1 shows, the State has focused its attention on acquiring assets in the financial, agricultural, and forestry sectors, as well as owning the traditional public utilities on the grounds of natural monopoly. It is a minority shareholder in the mining enterprises while its involvement in the financial sector has been designed to reduce the strong bias against lending to Nationals that this sector displayed at the end of the 1960s. The bias against Nationals has been reduced and there has been the emergence of a national bourgeoisie, although its leading edge is the naturalised bourgeoisie. Returns on investment in the Papua New Guinea Banking Corporation, which has the advantage of a captive clientele in the government departments, has been lower than that in the other commercial banks. Consequently, the State's participation in the financial sector on the one hand has created an entrepreneurial class, while on the other hand, it has been at a financial cost to the State.

The State has committed large volumes of investment resources to the mining sector. Its minority shareholding in the mining enterprises reflects the assumption that these are likely to be highly profitable enterprises and, therefore, provide a return greater than the norm. In practice, some of the enterprises such as Ok Tedi Mining Ltd., and Misima Mines Pty. Ltd., are marginal and have locked up large volumes of state funds, without any return. The government has committed approximately K300 million to the Ok Tedi project, but has not received any dividends for the first seven years of its operations. Instead, it has been forced to compromise on its environment policy because of its large commitment of funds. The Misima gold and silver mine has an anticipated life of ten years and the State had committed K50 million by 1991. However, no dividends were expected for the first four years of its operations.

Table 1: Government Commercial Investments

Enterprise	Sector	Government Percentage of Equity
Ok Tedi Mining Ltd.	Mining	20
Kutubu Joint Venture	Mining	22.5
Electricity Commission of Papua New Guinea (ELCOM)	Energy	100
Bougainville Copper Ltd.	Mining	20
Post & Telecommunications Corporation (PTC)	Communications	100
Papua New Guinea Harbours Board	Transport	100
Investment Corporation of Papua New Guinea	Finance	100
Air Niugini	Transport	100
Porgera Joint Venture	Mining	10
Misima Mines Pty. Ltd.	Mining	20
Mineral Resources Development Co. Pty. Ltd.	Mining	100
National Housing Corporation	Housing	100
Papua New Guinea Banking Corporation	Finance	100
Higaturu Oil Palms Pty. Ltd	Agriculture	44
Ramu Sugar Ltd.	Agriculture	48.9
New Britain Palm Oil Development Ltd.	Agriculture	50
Hargy Oil Palms Pty. Ltd.	Agriculture	50
Papua New Guinea Development Bank	Finance	100
PNG Forest Products Pty. Ltd.	Forestry	70
Stettin Bay Lumber Co. Pty. Ltd.	Forestry	16.6
National Broadcasting Commission (NBC)	Communications	100
Gogol Reforestation Co. Pty. Ltd.	Forestry	49
Niugini Insurance Corporation	Finance	100
Indosuez Niugini Bank Ltd.	Finance	32
Livestock Development Corporation	Agriculture	100
Pacific Forum Line	Transport	31.7
Kagamuga Natural Products Co. Pty. Ltd.	Agriculture	100
Cape Rodney Estates Pty. Ltd.	Agriculture	100
Higaturu Transport Pty. Ltd.	Transport	100
New Guinea Marine Products Pty. Ltd.	Fisheries	33
Davara House Ltd.	Hospitality	3

Sources: 1. Trebilock 1983: Table 1.
2. Minister for Finance and Planning 1991, Volume 1:16.

Although Bougainville Copper Ltd. has been more profitable, the return on shareholders' funds has generally been below fifteen percent during the 1980s, even before the mine was forced to close in May 1989. Both the Porgera Joint Venture and Kutubu Joint Venture projects are expected to be highly profitable. However, the Kutubu project has a life of only eleven years and at the end of 1991 the government was carrying a debt of K320 million against it. This debt

has built up because the government's 22.5 percent share has been 'carried' at a much higher interest rate than would have been the case if it had borrowed the capital on the London money market. In the aftermath of the pressures from North Solomons Province to increase the share of Bougainville Copper Ltd's surpluses accruing to the North Solomons Provincial Government and the landowners, the government has moved to shift some shareholding to provincial governments and to the landowners in which the mines are located. This move could be regarded as partial privatisation of the government's mining assets.

The State's participation in oil-palm projects has been highly successful in boosting production in this sector. During the 1980s, annual average production in this industry expanded at an annual rate of eleven percent. The success of this industry shows that State participation in joint projects, under nucleus estate arrangements and with proper identification of an ecologically suitable crop, can boost output and income for both the smallholders and the State. However, state participation in the Ramu sugar project has been harmful to the consumers, who have faced a two to threefold increase in the price of sugar. The benefits of this project have largely accrued to the Commonwealth Development Corporation, which has had a protected market to sell into and also manages the project. Ramu Sugar Ltd. was a nationalistic project directed against the Australian sugar producers, but the beneficiary of the project is a British multinational organisation.

Returns from forestry projects have been low. The sugar and forestry projects have aimed at getting economic activity moving in regions with potential land and forestry resources. Also, one objective has been to reduce interprovincial inequality. The Papua New Guinean participation in the loss-making Pacific Forum Line (PFL) has been designed to display inter-regional solidarity with other island states in the South Pacific. However, PFL's principal beneficiaries are Fiji and New Zealand because the bulk of its cargo is carried between those two countries. From a Papua New Guinean business viewpoint, there seems little sense or value in subsidising the relatively affluent economies of New Zealand and Fiji.

Nationalism and the assumption that returns from business would be a source of additional funds for the provincial governments also led to the creation of nineteen provincial development corporations. In his 1976 budget speech, the then Minister for Finance, Julius Chan, offered an interest free loan of K100 000 to all provincial governments. This loan was to be repaid in five years. In addition, the national government offered, for the creation of such provincial development corporations, an outright grant of fifty toea per head of population. The performance of such provincial development corporations has, in general, been marred by inadequate financial and management skills. Financial records have been deficient in most cases while the relatively profitable North Solomons Development Corporation collapsed in the post-1989 period with the onset of the Bougainville crisis.

The bulk of the State's investments outside the mining sector are in the natural monopolies of electricity — through the Electricity Commission of Papua New Guinea (ELCOM) — Posts and Telecommunications, the Harbours Board, and Air Niugini, which although not a natural monopoly, has been operating as a monopoly on the domestic trunk routes and shares the international market

with Qantas and some of the Asian airlines. These four monopolies form a significant part of the public sector and are enterprises over which the State has control. This is different from the large investments in the mining sector, where the State is a minority shareholder.

The independent State of Papua New Guinea acquired two of these investments as a successor State to the Australian colonial regime. The Harbours Board and the Post and Telecommunications monopolies were created by the Australian administration — the latter being a line department until 1982, when the Post and Telecommunications Corporation (PTC) was created as a statutory authority. Air Niugini was established in 1973 with its shares being held by the State, and the Australian firms, Qantas, TAA and Ansett. The State steadily acquired shares from these Australian firms and by 1981, one hundred percent equity was held by the Papua New Guinean Government. Between 1975 and 1983 Air Niugini and the Harbours Board operated independently of the government, but whereas Air Niugini paid excise and customs duties like enterprises in the private sector, the others did not.

In 1978, the Papua New Guinean Government requested the International Monetary Fund (IMF) to examine and make recommendations to improve the performance of these four monopolies. The Floyd Report (1979), which resulted from the IMF enquiry, essentially recommended that these four enterprises should:

- get prices right;
- pay all the relevant taxes that are paid by private sector enterprises; and
- reflect marginal social costs.

In addition, the Report recommended that their investment decisions should go through the National Public Expenditure budgetary process. Trebilock (1982) was critical of the latter recommendation arguing that the bureaucrats lacked the competence to make appropriate judgements about these different and highly complex business enterprises. Nevertheless, the recommendations of the Floyd Report have been steadily implemented and these four enterprises have become commercial statutory authorities (CSAs). However, their investments and terms and conditions of employment are examined by the Budgetary Priorities Committee and the Salaries and Monitoring Committee of the Cabinet. They have begun to produce corporate plans, but their performance remains rather chequered.

Despite the Floyd Report's recommendations, the cross-subsidisation issue has remained a thorny and contentious one because it was mistakenly seen by leading politicians and bureaucrats to promote one of the eight aims — reduction of interprovincial and inter-regional inequality. Changes in the electricity tariff are an example of conflict over this issue of cross-subsidisation. Here, Papua New Guinea has moved between regional electricity tariffs and uniform tariffs — the former being closer to a marginal costing principle, but the latter being preferred by politicians, because it cross-subsidises smaller urban centres at the expense of larger ones.

The argument for cross-subsidisation is weak because the Electricity Commission serves less than 50 000 customers, and these are the relatively well-

off in a population of 3.5 million. Nevertheless, the argument of interprovincial inequality is raised whenever the government moves to a policy of charging on the basis of marginal cost. In 1991, the Electricity Commmission was asked by the government to cease cross-subsidisation. Whitworth (1989) carried out a study of these four commercial statutory authorities and the following information is based on that research.

Elcom's profitability fluctuates with the level of rainfall, the price of diesel and the price of its output. Between 1979-1982, Elcom had poor profitability because 1979-1980 were years of high fuel prices, 1979-1982 were years of below average rainfall, and electricity tariffs remained constant during the 1976-1980 period. A tariff increase of more than sixty percent was granted between October 1980 and March 1981. Further increases were then granted in 1982 and 1983. As rainfall improved and the price of diesel declined during the 1980s, Elcom's profitability improved. There were changes in management in 1981, but it is unclear as to how much of the improvement could be accredited to such changes. Political interference, through political appointments on the board and more importantly in the determination of investment and pricing decisions, are likely to impact adversely on the performance of Elcom and other commercial statutory authorities.

Such political interference has clearly impacted adversely on the performance of Air Niugini, which, despite a monopoly on the major domestic routes and revenue-sharing arrangements with Qantas, has had several years of losses (see Table 2). Although there was a stagnating demand for domestic air services, new routes were opened to 'show the flag' and three Dash-7 aircraft were purchased for political reasons, to serve the smaller towns in the Highlands Region. The improved profitability with the introduction of KLM contract management between 1983-1986 (although helped by a decrease in the price of fuel) shows that management has had a critical role in the performance of Air Niugini.

Table 2: Air Niugini's Operating Profits/Losses, 1977-1988 (K millions)

Year	Profits/Losses
1977	1.2
1978	0.8
1979	-3.0
1980	-4.1
1981	2.0
1982	-2.3
1983	-6.1
1984	-1.6
1985	5.6
1986	6.7
1987	6.0
1988	2.2

Note: The KLM team arrived in February 1983 and left in March 1986.
Source: Whitworth 1989, Tables C1 and C2.

KLM's departure led to a drop in profitability. It appears that 1991 was a poor year for both Elcom and Air Niugini partly because of the Gulf War and the consequent rise in fuel prices.

The Harbours Board shows a fluctuating level of overall profitability, although the government has not received any company taxes or dividends. However, the uniform tariff policy has meant losses on the smaller ports and substantial profits on the larger ones. Cross-subsidisation has occurred until recently. There is an apparent increase in featherbedding ('x'-inefficiency), as staff has increased proportionately faster than tonnages handled.

The Namaliu government in late 1991 and early 1992 announced that it was asking the four commercial statutory authorities to stop cross-subsidisation and to focus on commercial objectives.

The Post and Telecommunication Corporation (PTC), unlike Air Niugini and Elcom, has been profitable throughout its history. However, this may simply reflect rapid technological advances (and thus reduction in costs of production) and expanding demand rather than good management. With more than 3 000 employees, PTC is by far the largest of the four commercial statutory authorities. 'X'-inefficiency (that is, poor management and work practices) seems rife in all of them. This is reflected in the fact that despite the monopoly power of such enterprises, 'the overall return on the Government's total investment of K232 million in 1989 was only 5.6 percent, which fell short of the return on investment targets for individual CSAs (Commercial Statutory Authorities) of 15-20 percent' (Minister for Finance and Planning 1991, Volume 1:19).

The commercial background of local managerial appointees was generally weak and they remained dependent on expatriate advice and support. The high turnover of skilled expatriates, even though poorly qualified expatriates stayed on, did not help the performance of such enterprises. The low returns on such investment have an opportunity cost for government.

However, the financial performance of individual commercial statutory authorities as well as their combined performance has tended to fluctuate (see Table 3). This reflects — as in the case of Air Niugini — the introduction of improved management as well as the upward adjustment of tariffs. Moreover, the government has only been vetting and monitoring corporate plans since 1983 and therefore this control is still in the process of being built up. Consequently, a conclusion that more rapid improvement in performance will occur, if such commercial statutory authorities were privatised, may not be valid. Nevertheless, there is a need for clear specification of objectives and continuous monitoring of performance against such objectives with attendant identification of reasons for the varying levels of performance between the different commercial statutory authorities.

Why Privatise?

The general arguments for privatisation have been discussed by Albon (1986). He argues that privatisation opens enterprises to market discipline which

Table 3: Financial Performance of Commercial Statutory Authorities, 1980-1989 (Percentage Return on Investment)

Year	Air Niugini	Elcom	PTC	Harbours Board	Combined
1980	-15.4	-3.1	8.0	1.1	0
1981	8.7	8.0	14.6	13.0	10.8
1982	- 7.8	12.8	21.3	12.6	12.7
1983	-26.8	10.1	8.9	13.9	6.8
1984	- 3.8	13.7	6.9	6.4	9.9
1985	31.1	13.1	9.3	8.2	12.7
1986	40.4	13.1	12.9	30.0	15.5
1987	28.0	12.0	13.1	26.0	14.1
1988	8.5	11.5	17.0	21.3	11.3
1989	-	-	-	-	5.7

Sources: 1. Whitworth 1989, Tables A1, B1, C1, and D1.
2. Minister for Finance and Planning 1991, **1992 Budget Papers**, Volume 1:19.

stimulates greater cost efficiency and more technical innovation for the following reasons:

- profitability becomes a sole, clearly defined objective;
- performance is measured by the share price;
- an underperforming firm will be subject to takeover;
- chronic underperformance can end in bankruptcy; and
- privatisation frees the firm from the need to attain 'social' objectives.

Public sector businesses suffer from chronic overstaffing and overcapitalisation. Unit costs are, therefore, excessive in public sector businesses. It follows that there is an opportunity cost of resources going into state-owned enterprises. There is the argument that, if the government cannot perform as well as the private sector, it should stay out of such enterprises and let the private sector do a better job. Under this argument, the State should focus on providing a sound law and order and social and physical infrastructure environment to facilitate private investment and growth.

Just as there were (and still are) economic and political forces that propelled the State in Papua New Guinea to adopt policies of public ownership, similarly, there has been the development of economic and political forces, which are promoting and causing a shift in stance towards privatisation. As already discussed, there has been the growth of a local bourgeoisie, the leading edge of which is the naturalised group. The growth in assets with this class has been through the creation of a financial sector which has been more conducive to its growth. Against this, the slow growth of the economy in the post-1973 period (at a rate of 1.5 percent during 1973-1991) has stymied its growth. It has consequently begun to seek other policies to increase its assets, and privatisation seems to be one of them.

The shift in government thinking in Papua New Guinea, is at least partly driven by changing ideological considerations. Nevertheless, there are other reasons which have underpinned this shift. The slow growth of the economy, stagnation in formal sector wage employment, the problem of absorbing a labour force which is expected to expand at an annual average of 50 000 during the 1990s, and the worsening law and order problem has led the government to look at various microeconomic reform measures to raise productivity. Such reforms are aimed at improving allocative and dynamic efficiency. With the Gross Investment Ratio (Gross Investment divided by Gross Domestic Product) averaging between twenty percent and twenty-five percent, and the Net Investment Ratio averaging between ten percent and fifteen percent, a GDP growth rate of 1.5 percent reveals the inefficiency in the use of both labour and capital.

As shown in Table 3, the average return on investment from commercial statutory authorities was low and fluctuating. However, as shown in Table 4, the share of commercial statutory authorities in total Gross Fixed Capital Formation (GFCF is a proxy for Gross Investment) was only about eight percent. The commercial statutory authorities had only a one-third share in total public sector GFCF and an eleven percent share of total non-mining GFCF. Consequently, even if productivity could be lifted in such enterprises, whether through privatisation or subcontracting of some activities to the private sector in order to generate an average rate of return by fifteen percent for such enterprises, it would make only a marginal difference to the growth of the Papua New Guinean economy. Moreover, it is unclear if the private sector performs all that much better than the commercial statutory authorities.

Table 4: Gross Fixed Capital Formation, 1986-1990 (K millions)

	1986	1987	1988	1989	1990
1. Total GFCF	539.2	551.2	737.0	790.7	772.9
2. Non-Mining GFCF	389.0	385.8	456.6	437.4	432.3
3. Public Sector	165.9	150.9	157.5	144.5	157.6
4. Commercial Statutory Authorities	46.6	46.6	56.5	41.8	47.1
$^4/_1$ (%)	8.6	8.5	7.7	5.3	6.1
$^4/_2$ (%)	12.0	12.1	12.4	9.6	11.1
$^4/_3$ (%)	28.1	30.1	35.9	28.9	11.1

Sources: Minister for Finance and Planning 1991, **1992 Budget Papers**, Volume 2, *Economic Policies*, Table S1.4.

There are a number of caveats, which are accepted by most economists advocating privatisation. Given the separation of ownership and management in large private firms, a privately owned natural monopoly is just as likely to generate 'x'-inefficiency; that is, lax management, as a state-owned natural

monopoly. Because a natural monopoly will have to be regulated, the question arises as to whether the cost of such regulation is likely to be less than that of the greater 'x'-inefficiency which may be generated under state ownership. The answer to this question is unclear, but improvements in 'soft productivity'; that is, through improvements in management and work practices even where they are likely to be effective, can add only twenty percent to productivity improvements. Hard productivity improvements come about through human and physical capital formation. Both 'soft productivity' and hard productivity improvements are influenced by institutional factors. Among the important ones are the length and intensity of the working week and the length of the school year. *Ceteris paribus*, where the former is short and weak, labour productivity is likely to be low and where the latter is short, improvement in skills is likely to be slow, thus retarding the growth rate of labour productivity and the economy.

PRIVATISATION IN PAPUA NEW GUINEA

Privatisation arguments in Papua New Guinea are driven by those persons who see a minimalist role for the government in commercial enterprises based on the assumption that the private sector is more efficient. Also, there are persons who believe that the government should focus its activities and resources on providing a secure environment for the private sector to invest in and on improving human capital; that is, it should focus on law and order and human resources development. Privatisation will result in the following outcomes according to the Minister for Finance and Planning (1991):

- independence from political pressures on pricing, employment, and investment policies;
- limitation of the role of government to provision of the minimum regulatory framework needed to protect the public interest in regard to such matters as the environment, safety in the work place, and sound labour relations;
- responsiveness to market forces, including, above all, the need to earn a competitive rate of return, which helps to ensure that output is not marketed at sub-economic prices; and
- attraction and promotion of private investment, which is likely to be more responsive when government is seen not to be directly involved in ownership of, or in competition with commercial enterprises (Minister for Finance and Planning 1991, Volume 1:18).

The Namaliu government accepted the need to privatise certain public sector enterprises and to commercialise and corporatise the operations of natural monopolies, which may be difficult to privatise for a number of reasons. The Electricity Commission, the Post and Telecommunication Corporation, the Harbours Board and Air Niugini have been given target rates of return of twenty to twenty-five percent and have been shorn of the responsibility of cross-subsidising rural consumers or those located in remoter areas. In addition, as a policy response to the Bougainville crisis, the government has moved to sell a

part of its equity in the mining projects to the respective provincial governments, and the landowners where the mines are located. For the non-petroleum/mining projects, it is offering parcels of five percent of the equity at nominal value and five percent at market value — the latter after three years of production. For the petroleum/mining industry, the government is offering one-seventh of its equity, with the sale of such equity to be split equally between the provincial government and the landowners in whose area the mine is located. Sale to the landowners of such equity can be seen as privatisation.

At the end of 1991, such an option to acquire equity had been taken up by Porgera and Kutubu landowners, but not by Ok Tedi or Misima landowners. Essentially, privatisation meant, in this case, the distribution of profits from the more successful mines, to the landowners. It is likely that this creates a class of rentiers (those who are dependent upon income without production), but whether or not this is transformed into a bourgeoisie, only time will tell. However, the experience of Bougainville Copper Limited, which provided similar rents to the Panguna landowners, suggests that this is unlikely to happen. The Panguna landowners remained essentially a group of rentiers who continuously sought larger and larger rents with each upswing of the gold and copper prices.

Connected to this is the general problem of a weak State, whose authority is fragmented by nineteen provincial governments, with the richer provinces constantly seeking greater autonomy from the national government — and sometimes getting it, as amply demonstrated by North Solomons Province. This weakness of the State is evident at another level, with the seesawing of policy within the Cabinet on privatisation and publicisation. Such seesawing is apparent in the case of the gas company issue which is discussed later.

The enterprises which have been targeted for privatisation by the Namaliu government are relatively small, although they are obviously large businesses for any Nationals who may wish to acquire them. These enterprises are the Niugini Insurance Corporation, Nambawan Finance Ltd. — which is a subsidiary of the Papua New Guinea Banking Corporation — Hargy Oil Palms Pty. Ltd., and Higaturu Transport Pty. Ltd.

However, there are several problems that the State is likely to face in attempting to privatise even these operations. First, the small size of the national bourgeoisie, outside the naturalised bourgeoisie, means that there is likely to be a shortage of entrepreneurial and management talent to successfully run such enterprises; the Papua New Guinea Development Bank was forced to acquire several businesses, because they were making losses, when operated by private enterprises (Trebilock 1983:135). Second, the absence of a stock exchange will limit the extent to which the market will be able to make a judgement about the performance of such businesses, when privatised. The Papua New Guinean Government has been working on the establishment of a stock exchange in Port Moresby since 1987, but at this point in time, such a stock exchange has not eventuated. Third, the traditional system of sharing assets and income with other members of a clan limits the incentive for local business persons to reinvest and expand their businesses. Also, there is the absence of a commercial tradition. More seriously, there is the attraction of the short working week in the public service and in wage employment, which reduces the attraction of acquiring

private businesses, as the latter require a much longer working week to achieve success.

Substantial privatisation is also limited by the stagnation in the share of Gross Saving in the Gross Domestic Product (Gross Domestic Saving Ratio). Despite constraints in government expenditure, Papua New Guinea has only managed to record an annual average Gross Domestic Saving Ratio of approximately fourteen percent per annum during the 1980-1989 period (see Table 5). Gross Domestic Saving is obtained by subtracting the import surplus from Gross Investment. Against this, Gross National Saving Ratio (which is obtained by adding Net Factor Income from abroad and Net Current Transfers from abroad to Gross Domestic Saving) has recorded an average of fifteen percent over the same period.

Whereas, until 1986, the latter has tended to be greater than the former, in more recent years the former has tended to exceed the latter (see Table 5). This is because Net Private Current Transfers abroad have tended to rise as the law and order situation has worsened in Papua New Guinea, while official Net Current Transfers have continued to decline (with a decline in Australian aid). Also, Net Factor Income abroad, which has always been negative, has tended to rise as companies have continued to pay an increasing proportion of their surpluses abroad, in the form of interest and dividends.

Table 5: Gross Saving Ratios, 1980-1989

Year	Gross Domestic Saving Ratio	Gross National Saving Ratio
1980	15	19
1981	6	12
1982	11	15
1983	14	18
1984	15	16
1985	10	11
1986	14	16
1987	16	15
1988	20	16
1989	14	13

Sources: 1. Goodman, Lepani and Morawetz 1985, Table A5.
2. Calculated from the Minister for Finance and Planning, 1991 and 1992 **Budget Papers**, Volumes 2, Tables S1.6 and S1.2.

Nevertheless, Papua New Guinea has steadily built up a bourgeoisie since the late 1960s and it is under the pressure from such bourgeoisie that the privatisation programme is being pursued. Also, there is the push from the World Bank, as privatisation is one of the pillars of the microeconomic reform process that is aimed at economic efficiency in all economies. In Papua New Guinea, the conflict still remains between those who assume that the State should take a stake in or set up enterprises, which may be highly profitable or which may have a public interest (keeping an eye on mining multinationals has been an

argument for the State assuming a minority stake in such enterprises) and those who believe that the State should keep out of commercial ventures. The former assume that the local bourgeoisie is too weak and if the State does not take the initiative to participate in business, the surpluses from mineral resources will increasingly flow abroad. The conflict between such views is demonstrated in the (January 1992) Cabinet decision to set up a Papua New Guinea National Oil and Gas Company (PNGNOGC), which is to be responsible for:

- upstream and downstream development and processing, respectively, of oil and gas resources in Papua New Guinea;
- marketing and administration operations encompassing sales and purchase of oil and gas resources from or to Papua New Guinea;
- tanker, transport and bunkering operations encompassing all transport and communications-related activities of oil and gas resources; and
- a tenders and contract coordination body to ensure equitable local participation in oil and gas resources (Post-Courier, 31 January 1992:5).

The PNGNOGC was expected to pre-finance its operations including the purchase of a tanker through a pre-contract sales agreement with its share of oil (22.5%) from the Kutubu project. The Cabinet statement indicated that an initial outlay of K20 million would be required, but Joe Tauvasa, a member of the national bourgeoisie whose transport operations were likely to be affected adversely, argued that it would cost at least ten times as much and would add to the nation's debt burden. Also, the Cabinet was not united in its decision. Patterson Lowa, Minister for Minerals and Energy, whose department had been bypassed in the formulation of the new policy argued (with Joe Tauvasa) that whereas the government talked privatisation, it practised the extension of State activities in areas which should be left to the private sector.

Lowa, like most of the members of the Melanesian Alliance Party, has come to believe that the State should focus itself on the first of the eight National Goals and Directive Principles — Integral Human Development — that is, state resources should be devoted to the development of education and health services. In addition, there is the view that the State should provide a secure environment (including law and order) in which the private sector will be allowed to flourish. On the other hand, there are those people who believe that the large multinationals which are involved in the resources sector continue to transfer huge surpluses out of the country through transfer pricing and management fees and, therefore, the State needs to extend its operations in natural resource development.

There is the central issue of whether or not the State will be able to successfully manage such a large enterprise. Past performance of state enterprises has been variable, but is highly dependent on good external management input. However, the PNGNOGC issue reflects bureaucratic and Cabinet in-fighting. The bureaucratic in-fighting results from the large mineral resources, which are currently being controlled by the Mineral Resources Development Company Pty. Ltd. (MRDC), a parastatal set-up by the government to manage its share of equity in the mining projects. MRDC's subsidiary, Kutubu Joint Venture manages the State's 22.5 percent equity in the oil project. The creation of PNGNOGC would have reduced the power of the Mineral Resources Development Company while extending those of other bureaucrats in whose

hands PNGNOGC would have fallen. The coalition of private sector interests, which opposed the formation of PNGNOGC and those in the government opposed to such a venture, was balanced against those who were pushing for its formation. Nevertheless, it is a clear demonstration of a division and lack of a clear policy focus in decision making and reflects the weakness of the State in Papua New Guinea.

CONCLUSION

The scope for successful privatisation in Papua New Guinea in the immediate future remains limited for several reasons. The limited size of the national bourgeoisie is one important constraint. The privatisation of the Niugini Insurance Corporation in December 1991 was only possible with the support of the major institutions — a number of which, such as the Papua New Guinea Banking Corporation are part of the public sector. In addition, given the relatively small proportion of investment for which the government commercial investments are responsible, the improvement in the growth rate because of an improved performance from privatisation or from a greater commercial focus of such enterprises is likely to be small — less than 0.5 percent even on the most optimistic assumptions. Commercialisation with a clearer identification and regular measurement of performance indicators under agreed corporate plans between Boards of government, business enterprises and the State remains a viable alternative to privatisation, as long as the national bourgeoisie and the State remain weak.

It is important to note that Papua New Guinea's poor economic performance is more the consequence of late colonialism under which it has adopted a short working week, a short education year and low student-staff ratios in the educational institutions, which have seriously dampened improvements in productivity. Without serious attempts to wind back these adverse impacts, the growth of economic space for the national bourgeoisie will be a slow process. In addition, Papua New Guinea's budgetary aid overhang, under which it has wound back the high levels of Australian budgetary aid that it had inherited at self-government, means that public sector expenditure has been constrained in the post-colonial period and will remain constrained in the 1990s (Gupta 1991).

Also, this means that infrastructure improvements remain stunted and where these have been undertaken there are inadequate resources for their maintenance. Papua New Guinea, like New Zealand and Australia, has been searching for policies which would save it from the economic stagnation that has gripped it. However, privatisation in New Zealand has not boosted the growth rate in that country, and neither will it make much difference in Papua New Guinea. Nevertheless, the national bourgeoisie will continue to push for additional economic space, and privatisation is one of these vehicles. Without a dynamic bourgeoisie with expanding economic space, Papua New Guinea's capitalist system, like capitalist systems anywhere else, remain on a low growth or stagnationist trajectory.

Japan, in the absence of a local entrepreneurial class, started off after the Meiji Revolution, with state capitalism. Towards the end of the nineteenth century and beginning of the twentieth century, state enterprises were sold at throwaway prices to create private companies which eventually formed the nucleus of the Zaibatsu. In Papua New Guinea, the post-colonial State started off by similarly starting and continuing with pre-colonial commercial enterprises, while encouraging the expansion of a national bourgeoisie at the same time.

Whether or not Papua New Guinea could expand economic space for its national bourgeoisie by privatising and thus creating a similar nucleus with similar results, remains doubtful. Whereas Japan had a strong State, that was able to create other institutional arrangements, which encouraged economic growth, these institutional arrangements are missing in Papua New Guinea, where there is essentially a weak State. Only time will tell whether the national bourgeoisie will be able to dominate economic policy formulation to create appropriate institutional arrangements to encourage economic growth.

The current policy debate remains bogged down between those who continue to push for the extension of the State into the commercial sector and those who advocate a more limited role for it. Even in terms of a pricing policy by commercial statutory authorities, the issue of cross-subsidisation is not yet dead. There are those who support its continuation on the grounds of promoting interprovincial and inter-regional equality and those who push for its abolition on the grounds of economic efficiency. The latter group appeared to have won this policy issue in 1991-1992 — not unsurprisingly considering that changes in the economic status of a province are highly dependent on the commercialisation of potential natural resources and not on cross-subsidisation. Cross-subsidies only benefited a few of the users of such services resident in these provinces. It made little difference to the initiation of new natural resource projects.

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