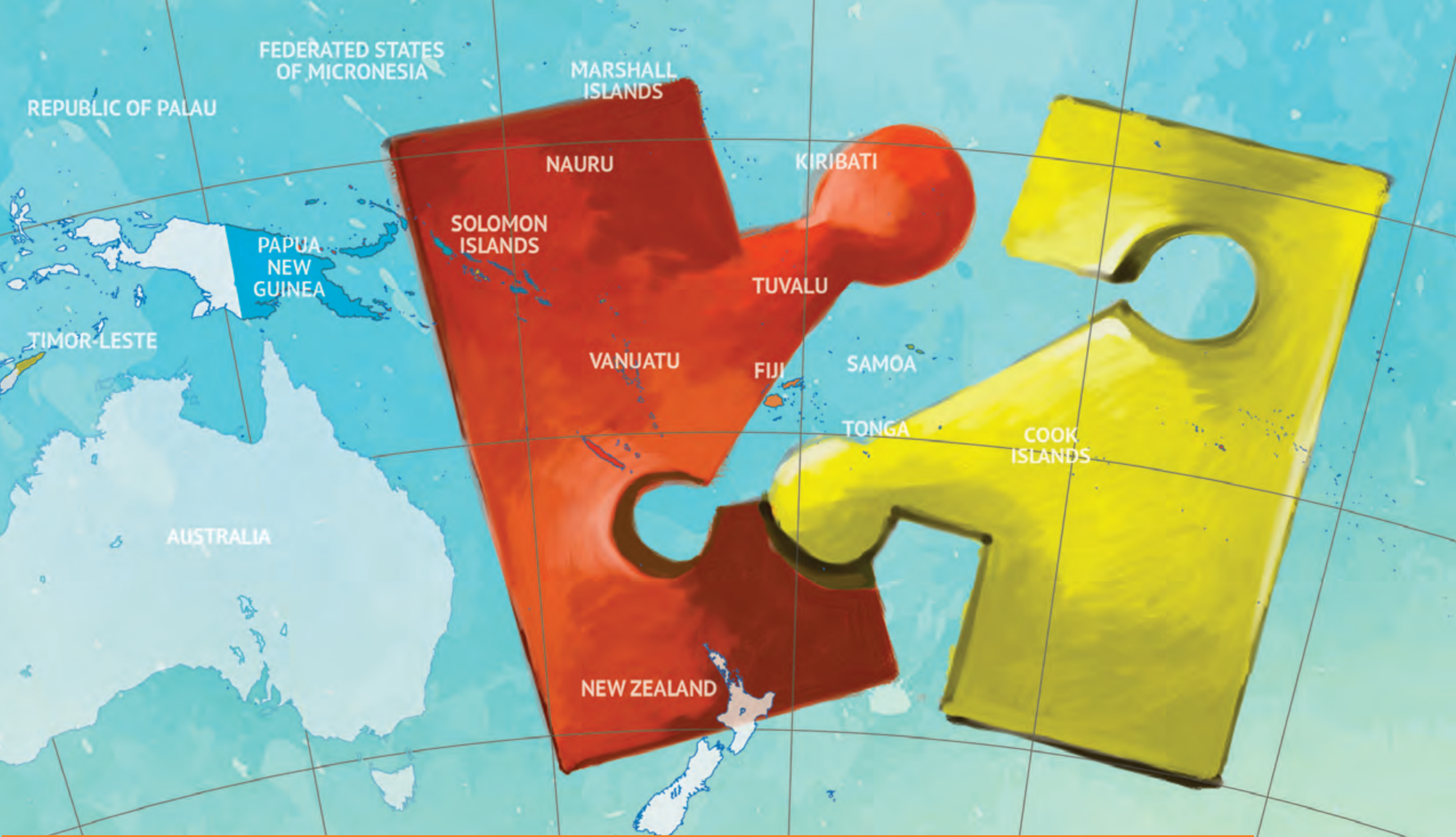

FINDING BALANCE 2016

BENCHMARKING THE PERFORMANCE OF STATE-OWNED ENTERPRISES IN ISLAND COUNTRIES

ASIAN DEVELOPMENT BANK

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FOREWORD

Pacific island countries recognize the importance of trade, investment, and private sector development to inclusive economic growth. For more than a decade, Pacific island countries have been introducing policy, legal, and institutional reforms to improve their business environments, including reforms to state-owned enterprises (SOEs) that provide many of the basic infrastructure services on which private firms depend for their competitiveness. These reforms have translated into improved SOE performance, increased formal business creation, and new investment. The lesson from this experience is that reform takes time and political commitment, but it works.

SOEs remain a dominant feature of Pacific island economies, providing core infrastructure services (e.g., airports, broadcasting, postal services, power, sanitation, seaports, telecommunication, and water) on a monopoly basis, as well as a range of other commercial activities, often in competition with the private sector. Reforms have strengthened the legal, regulatory, and governance frameworks under which they operate, and introduced partnerships with the private sector, bringing new investments, innovation, and management expertise.

This is the fifth comparative study of SOE performance in the Pacific undertaken by the Asian Development Bank (ADB), and the first to include Kiribati and Vanuatu. At the request of the Pacific island countries participating in the study, each edition expands the number of countries covered. In this edition, New Zealand and Singapore were added to enrich the global benchmark.

The study demonstrates the importance of political commitment to drive SOE reform. When this commitment wanes, SOE performance tends to follow. Involving the private sector through public–private partnerships and privatization is a more sustainable way to improve SOE performance. Competition for investment capital means that the private sector will always have stronger performance incentives than the public sector. These incentives can be harnessed to support public service delivery.

Governments engaging in SOE reform are increasingly asking themselves whether they need to own and manage SOEs in order to deliver public services. As the experience of Fiji, the Marshall Islands, Papua New Guinea, Samoa, and Vanuatu demonstrate, partnerships with the private sector can expand the capacity of governments to deliver public services efficiently. A key theme of this study is finding the balance between the roles of the public and private sectors.

The study reflects ADB's ongoing commitment to increasing cooperation among developing countries on economic development issues and thought leadership on SOE reforms. The 10 participating countries (Fiji, Kiribati, Jamaica, the Marshall Islands, Mauritius, Papua New Guinea, Samoa, Solomon Islands, Tonga, and Vanuatu) were selected for their comparability and SOE reform experience. We commend their participation as demonstrating their governments' willingness to identify and address the core issues within their SOE sectors. This transparency is an essential precursor to successful reform.

I thank the governments of all participating countries for their extensive inputs, without which this study would not have been possible. I also wish to thank the authors, Laure Darcy and Christopher Russell, and financial analyst, Minh Vu, for their efforts, and the Government of Australia and the Government of New Zealand, which provided cofinancing under the Pacific Private Sector Development Initiative.

I am confident that the study will provide thought-provoking insights and stimulate useful discussions toward further progress in SOE reforms in the Pacific and other regions facing similar challenges.

Xianbin Yao
Director General, Pacific Department
Asian Development Bank

ABBREVIATIONS

ADB	Asian Development Bank
AFL	Airports Fiji Limited
AVOL	Air Vanuatu
AVL	Airports Vanuatu Limited
CEMA	Commodities Export Marketing Authority
CSO	community service obligation
EVA	economic value added
FEA	Fiji Electricity Authority
FY	fiscal year
GDP	gross domestic product
MEC	Marshall Energy Company
MIDB	Marshall Islands Development Bank
MPE	Ministry of Public Enterprises
NEC	National Executive Council
NROCC	National Road Operating & Constructing Company
OPSG	Office of Public Sector Governance
PBMA	Public Bodies Management and Accountability Act
PNG	Papua New Guinea
PPP	public–private partnership
ROA	return on assets
ROE	return on equity
SIEA	Solomon Islands Electricity Authority
SIPA	Solomon Islands Port Authority
SIWA	Solomon Islands Water Authority
SOE	state-owned enterprise
TSK	Telecom Services Kiribati
UNELCO	Union Electrique du Vanuatu

CURRENCIES

In this report, “$” refers to US dollars, unless otherwise stated.

A$	Australian dollar
F$	Fiji dollar
J$	Jamaican dollar
K	Papua New Guinean kina
MUR	Mauritian rupee
NZ$	New Zealand dollar
S$	Singapore dollar
SI$	Solomon Islands dollar
ST	Samoan tala
T$	Tongan pa’anga
$	US dollar
Vt	Vanuatu vatu

EXECUTIVE SUMMARY

This study assesses the financial performance of state-owned enterprise (SOE) portfolios in 10 developing island economies; reviews their legal, institutional, and governance frameworks; and draws lessons from their efforts at reform.

This is the fifth in a series of SOE benchmarking studies launched by the Asian Development Bank (ADB) in 2009, and the first to include Kiribati, Vanuatu, and two developed country benchmarks: New Zealand and Singapore. The latter two countries have been included for (i) the relevance of their reform experience; and (ii) the perceived success of their SOE portfolios, the structure of which many countries have sought to emulate. The study also includes Jamaica and Mauritius, two island economies outside of the Pacific which present relevant benchmarks due to their large SOE portfolios, long history of reform, and readily available financial data.

The SOE portfolios in the 10 developing island economies participating in this study are dominated by infrastructure service providers (e.g., airports, seaports, power, water, sanitation, broadcasting, postal services, and telecommunication), but also include a range of other commercially oriented undertakings such as transport and banking.

The study reveals that while SOEs are often established to address perceived market failures or increase accountability in public service delivery, these goals are rarely achieved. Only one of the 10 SOE portfolios produced a return sufficient to cover capital costs from 2010 to 2014. Four produced average returns on assets (ROA) and/or return on equity (ROE) below zero over this period.

In most countries, these low returns are achieved despite subsidized capital, monopoly market power, and ongoing government cash transfers. The low returns on SOE investment dampen economic growth. Despite governments' sizeable investments in the SOEs, they contribute only 0.3%–12% to gross domestic product (GDP) in the benchmarked countries.

The poor financial performance of the SOEs is corroborated by low productivity levels. A detailed analysis of 25 infrastructure SOEs in the Pacific confirms that productivity is well below developed country benchmarks, but is improving in those countries undertaking reforms.

State-Owned Enterprise Portfolio Performance Indicators (%)

Country	Average Return on Assets FY2010–FY2014	Average Return on Equity FY2010–FY2014	Contribution to GDP 2014
Solomon Islands	6.7	10.0	3.6
Marshall Islands	(3.7)	(8.1)	5.3
Mauritius	3.4	7.4	1.9
Kiribati[a]	2.8	3.8	11.9
Tonga	2.5	3.9	7.1
Fiji	1.5	3.3	4.3
Papua New Guinea	1.3	2.4	1.8
Vanuatu (FY2010–FY2013)	0.8	3.7	1.8
Samoa	(0.3)	(0.6)	3.0
Jamaica	(2.3)	(15.1)	0.3
New Zealand	(0.4)	(1.3)	1.2
Singapore	5.1	10.4	3.9

( ) = negative, FY = fiscal year, GDP = gross domestic product.

[a] The financial results of the Kiribati state-owned enterprise portfolio must be treated with some caution, as few of the state-owned enterprises received unqualified audit reports.

Sources: World Bank. World Bank Development Indicators. http://databank.worldbank.org/data/home.aspx; accounts provided by countries and publicly available sources.

The study shows that low SOE returns are not unique to the Pacific (nor to island economies), and are common throughout the developing and developed world.

In New Zealand, which undertook a very successful SOE reform program in the late 1980s, portfolio performance steadily declined from 2000 onwards, as political commitment and accountability for achieving commercial returns waned.

In Singapore, the SOE portfolio has consistently returned an average of 10% on equity and—due to very high gearing (arguably achievable with implicit government guarantees)—an average return on assets (ROA) of 5% during the 2010–2014 period. Singapore's strong financial performance masks relatively low average economic value added of 2.4% in 2009–2014.

Chronic SOE portfolio underperformance highlights a fundamental flaw in the SOE model: It is not an effective long-term ownership structure. While the SOE model attempts to replicate private ownership incentives and dynamics, it never truly replaces the market disciplines that private firms face. As long as SOEs remain under majority public ownership, politicians will avoid commercial decisions with potential short-term political costs.

Policymakers around the world are aware of SOEs' chronic underperformance, fiscal costs, and negative impact on growth and poverty alleviation. Consequently, efforts to reform SOEs have been ongoing for decades. This experience demonstrates that privatization, supported by robust regulatory arrangements, is the most effective mechanism for long-term improvements in state assets' productivity. However, full privatization is not always politically feasible nor the most suitable reform mechanism; partial privatization (public listings, joint ventures, and public–private partnerships [PPPs]) can also help improve SOE performance.

While the 10 countries have made important progress towards placing their SOEs on a more commercial footing, much more needs to be done. Key milestones from 2009 to 2015 include:

Fiji: privatizing 51% of Ports Terminal Limited and entering into a management contract for the Suva and Lautoka ports in 2013; privatizing 100% of Fiji Dairy, 51% of Fintel, and 59% of Fiji Ports Corporation; and merging the Ministry of Finance SOE monitoring team within the Ministry of Public Enterprises in 2014.

Jamaica: selling Air Jamaica in 2011; establishing a PPP for Jamaica's largest airport in Montego Bay; updating the privatization policy; strengthening the Public Enterprise Division; amending the Corporate Governance Framework for Public Bodies (first introduced in 2011); strengthening the Public Bodies Management Act and Regulations; and introducing a code of conduct for directors in 2015.

Kiribati: adopting a SOE Act in 2012; privatizing Kiribati Supplies Company Limited, Bobotin Kiribati Limited, and Telecom Services Kiribati; completing a PPP for Otintaai Hotel Limited in 2013; establishing an SOE monitoring unit; and adopting a skills-based director selection process.

Marshall Islands: restructuring the Marshall Energy Company, moving from a loss of $1.7 million in 2010 to a profit of $2.2 million in 2013; implementing a PPP agreement to finance new renewable energy generation; and adopting a comprehensive SOE Act in 2015.

Mauritius: restructuring seven SOEs in 2012–2013 and initiating the restructuring of Mauritius Shipping Corporation in 2015; passing amendments in 2009–2012 to strengthen the Statutory Bodies (Audit and Accountability) Act; strengthening the PPP framework; moving The Office of Public Sector Governance, established in 2010, into the new Ministry of Financial Services; and adopting the Good Governance and Institutional Reform in 2015.

Papua New Guinea: endorsing a Community Service Obligations (CSO) Policy for SOEs in 2013, undertaking the first pilot in 2015; and passing the PPP Act in 2014.

Samoa: privatizing SamoaTel in 2010; establishing the Independent Selection Committee for directors in 2010; adopting the Composition Act in 2012 to remove all politicians from SOE boards; adopting a SOE divestment and ownership policy in 2015; preparing the privatization of Agricultural Stores Corporation and announcing the intent to privatize Public Trustee and Samoa Post Limited; and establishing a new SOE ministry under a minister of SOEs.

Solomon Islands: divesting four SOEs since 2008; restructuring three major SOEs since 2010, and approving commercial tariffs for the water and power SOEs; completing CSO contracts for selected SOEs and integrating the process into government budgets since 2013; and programming the development of a new SOE capitalization policy in 2016.

Tonga: liquidating two SOEs; contracting out Tonga Water Board's plumbing services in 2015; awarding six CSO contracts, of which two were awarded to the private sector; implementing skills-based SOE director selection in 2013; strengthening the SOE Act in 2010, removing all ministers from SOE boards; publishing SOE results in local newspapers from 2010; and adopting a SOE divestment and ownership policy in 2015 incorporating a privatization and reform pipeline.

Vanuatu: divesting 30% of the National Bank of Vanuatu in 2012; adopting a broad-based SOE reform policy in 2013; preparing a draft SOE Act in 2015; and preparing privatization plans for SOEs.

Together with decades of international SOE reform experience, this study provides very clear lessons:

- As long as SOEs remain under government control, the risks of political interference and noncommercial decision-making remain high.
- Governments have tried to address this fundamental flaw by creating legal, governance, and monitoring frameworks to mimic the conditions and incentives faced by private sector firms. Comprehensive SOE frameworks only lead to improved SOE performance, if the political will to implement them exists.
- SOEs perform best in an environment supporting full commercial orientation, with strong governance, performance incentives, and hard budget constraints. Each of the 10 countries has some elements of this, but all depend on political support for implementation.
- Declining SOE performance is directly linked to weakened political commitment to protect and enforce the commercial imperative.

This study demonstrates the significant economic costs generated by poor SOE management, and the benefits resulting from reform. The improved profitability of 7 of the 10 SOE portfolios since 2010 is a compelling illustration. Ensuring SOEs are commercially focused and accountable frees scarce resources, enables them to start contributing to economic growth, and leads to increased investment and an expanded private sector to drive this growth.

I. INTRODUCTION

This study reviews the historical financial performance of state-owned enterprises (SOEs) in selected island economies, identifies the drivers of performance, and outlines successful reform strategies to inform future policy action. The study examines SOE performance and reform efforts in 10 countries: eight from the Pacific region (Fiji, Kiribati, the Marshall Islands, Papua New Guinea [PNG], Samoa, Solomon Islands, Tonga, and Vanuatu) and two from outside the Pacific (Jamaica and Mauritius). Singapore and New Zealand were included to contrast the performance with developed countries.

Countries participating in prior studies conducted in 2009, 2011, 2012, and 2014 requested that the study be regularly updated, and that other countries be invited to participate. This study responds to this request.

Participating countries were selected based on: (i) their willingness to share their SOE financial accounts, (ii) the comparability of the SOE portfolios, and (iii) the relevance of their SOE reform experience. While the countries vary significantly in size, population, and growth rates (Table 1), they are reasonably comparable due to their history of SOE reform and broadly similar SOE portfolios. This is also true of Jamaica and Mauritius.

The study does not consider the unique context of Pacific micro states such as Nauru, Niue, Tokelau, and Tuvalu. With populations of approximately 10,000 or less, these countries face greater challenges in attracting private investment in the provision of infrastructure services.

In this study, SOE refers to public enterprises, commercial statutory authorities, government commercial companies, and public trading bodies that are majority-owned by the state. All are corporatized and, with few exceptions, have a for-profit mandate. Only these entities are included in this benchmarking study. Mutual financial institutions, such as insurance companies and provident funds, are excluded as their shares are owned by their contributors, not the government. Some resource and petroleum SOEs, held and managed outside of the SOE monitoring units, have also been excluded. A detailed list of the included SOEs is provided in Appendix 1.

Where available, financial data covers the period from 2002 to 2014. However the emphasis is on the period from 2010 to 2014. This most recent period excludes the effect of the global financial crisis. The study was prepared with the active support of the ministries of finance or public enterprises in each of the survey countries. Each ministry provided audited

Table 1: Survey Country Economic Indicators

Country	Population 2014 Total	GDP 2014 ($ million)	GDP per Capita ($)	GDP per Capita Growth[a] (Average %) 2010–2014
Fiji	886,450	4,069	4,590	5
Jamaica	2,721,252	14,101	5,182	7
Kiribati	110,470	167	1,509	2
Marshall Islands	52,898	193	3,649	4
Mauritius	1,260,934	13,082	10,375	6
Papua New Guinea	7,463,577	18,874	2,529	13
Samoa	191,845	823	4,288	3
Solomon Islands	572,171	1,169	2,043	10
Tonga	105,586	424	4,020	3
Vanuatu	258,883	966	3,732	8
New Zealand	4,509,700	191,585	42,483	4
Singapore	5,469,700	307,937	56,299	7

GDP = gross domestic product.

[a] The growth rate is calculated based on nominal price and in local currency.

Source: World Bank. World Development Indicators. http://databank.worldbank.org/data/home.aspx financial information on its SOEs, copies of SOE legislation, and completed a questionnaire broadly describing its SOE monitoring practices and governance arrangements. This information was then discussed with each agency for further clarification, before being assessed comparatively across the 10 countries.

The study also explores broader international experience with SOE reform, identifies what has or has not worked, and highlights the key elements of successful policies. While the primary focus is on the comparative financial performance of the 10 SOE portfolios, the study also looks at the underlying legislative frameworks, the monitoring structures, governance arrangements, and the extent and nature of parliamentary oversight, as these factors can have an impact on the performance of the SOEs.

In March 2016, ministers and heads of departments responsible for SOEs in each of the surveyed countries were invited to a Leaders Seminar on State-Owned Enterprise Reform in Sydney. The seminar provided a unique opportunity to share reform experience and strategies. All participants provided comments on the working draft of the study, which have been incorporated in this report.

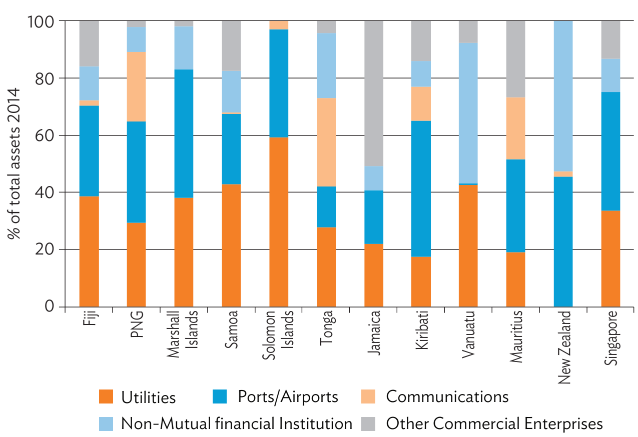
II. ECONOMIC IMPACT OF THE STATE-OWNED ENTERPRISE PORTFOLIOS

A. PORTFOLIO COMPOSITION

The state-owned enterprises (SOEs) in this study are primarily engaged in two broad activities: (a) the delivery of core public infrastructure services—airports, broadcasting, postal services, power, sanitation, seaports, telecommunication, and water; and (b) a range of other commercially oriented undertakings such as transport, banking, food processing, property development, tourism, agriculture, oil, and gas.

In 9 of the 12 countries participating in this study, infrastructure SOEs dominate the portfolio, representing 68%–100% of total assets in 2014 (Figure 1). Jamaica (59%), New Zealand (57%), and Vanuatu (60%) have large percentages of noninfrastructure SOEs, engaging in activities for which there does not appear to be a strategic justification and which crowd out the private sector.

Figure 1: Composition of State-Owned Enterprise Portfolios, FY2014



FY = fiscal year, PNG = Papua New Guinea.

Sources: Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism; Government of PNG, Kumul Consolidated Holdings; Government of the Marshall Islands annual economic statistics tables and annual SOE audit reports; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of Solomon Islands, Ministry of Finance; Government of Tonga, Ministry of Public Enterprises; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; Government of Vanuatu, Department of Finance and Treasury; Government of Mauritius, Ministry of Finance and Economic Development of Mauritius; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

B. CONTRIBUTION TO GROSS DOMESTIC PRODUCT

Investments in SOEs are substantial, yet their contribution to gross domestic product (GDP) remains low. SOEs control 7%–21% of total fixed capital in each country yet contributed only 0%–12% to GDP in 2014 (Figure 2).[1] In developed countries (New Zealand and Singapore), SOEs control 5%–9% of total fixed capital and contribute 1%–4% to GDP. The SOEs in this survey are among the largest commercial entities in their respective countries. In general, large businesses are almost always more productive than small businesses. When a SOE's contribution to GDP is much smaller than the portion of fixed assets that they use in the economy, this inefficiency acts as a drag on economic growth.

On average, for every 1% share of total fixed capital, SOEs in the survey countries contribute only 0.28% to GDP (Figure 2). Singapore's SOEs contribute 0.44% to GDP for every 1% share of total fixed capital—nearly double the average of the surveyed countries, primarily due to their stronger commercial orientation, governance arrangements, and accountability framework. Singapore's SOEs control roughly the same share of total fixed investment in their economy (9%) as Vanuatu (9%) and PNG (10%), yet contributed twice as much to GDP (2% both for Vanuatu and PNG). On this measure, Kiribati is the best performer in the survey sample, contributing 0.67% to GDP for each 1% share of total fixed capital. New Zealand's performance is similar to the surveyed countries due to the high cost of restructuring two large SOEs in 2012.[2]

C. IMPACT ON THE PRIVATE SECTOR

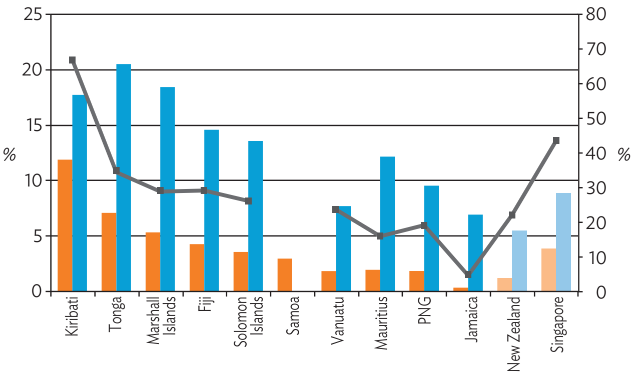
In most of the countries in this study, vital infrastructure services such as utilities and transport are provided exclusively by SOEs. When these are of low quality and/or high cost, they affect the competitiveness of the private sector.

SOEs reduce growth by crowding out the private sector and dampening the competitiveness of domestic industries.

1 Due to data deficiencies, there is a large margin for error in these calculations. However, even in using the most optimistic estimates in a sensitivity analysis of the capital output ratio for countries in the sample over a 10-year period, it appears that the low productivity of SOEs could have resulted in a 10%–20% reduction in GDP. This is a very large economic cost imposed on this study's sample countries.

2 The restructuring of NZ Rail and Solid Energy resulted in a combined loss in those two SOEs of NZ$2.7 billion in 2012.

Figure 2: State-Owned Enterprise Contribution to Gross Domestic Product vs. Total Fixed Capital Controlled by State-Owned Enterprises, FY2014



FY = fiscal year, GDP = gross domestic product, LHS = left-hand side, SOE = state-owned enterprise, PNG = Papua New Guinea, RHS = right-hand side, vs. = versus.

Sources: ADB. 2015. *Key Indicators for Asia and the Pacific 2015*. Manila; ADB estimates; World Bank. World Development Indicators. http://databank.worldbank.org/data/home.aspx; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; Government of Tonga, Ministry of Public Enterprises; Government of the Marshall Islands annual economic statistics tables, and annual SOE audit reports; Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism; Government of Solomon Islands, Ministry of Finance; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of Vanuatu, Department of Finance and Treasury; Government of Mauritius, Office of Public Sector Governance; Government of PNG, Kumul Consolidated Holdings; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

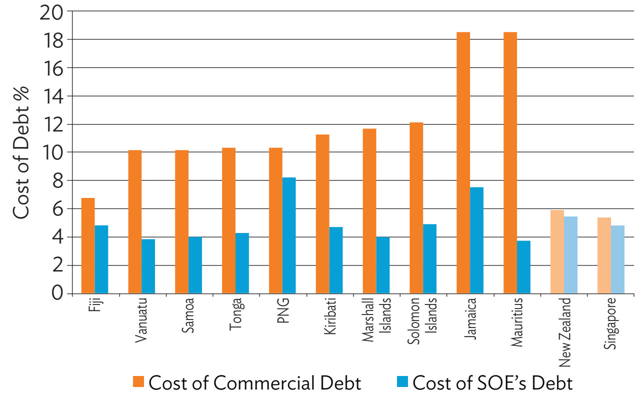
When SOEs compete with private sector companies, they often do so on a favored basis, making it difficult for private sector competitors to invest and grow. Although private sector firms are generally more efficient, and are not burdened with community service obligations (CSOs), SOEs enjoy a competitive advantage in three key areas:

- **Preferred access to government contracts**
- **Subsidized capital.** SOE debt and equity costs are generally lower than private sector firms', allowing them to remain marginally profitable even though they are less efficient than their private competitors.
- **Monopoly** provision of services in some cases

Subsidized debt, like subsidized equity, creates economic distortions. The interest rates SOEs pay on their debt are substantially below commercial rates (Figure 3). The low financing costs are a result of:

- explicit and implicit government guarantees; and
- soft loans provided by government entities or onlent from donors.

Figure 3: Average Cost of State-Owned Enterprise Debt vs. Commercial Debt Rate, FY2010–FY2014



PNG = Papua New Guinea, SOE = state-owned enterprise, vs. = versus.

Sources: International Monetary Fund. International Financial Statistics; Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism; Government of Vanuatu, Department of Finance and Treasury; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of Tonga, Ministry of Public Enterprises; Government of PNG, Independent Public Business Corporation; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; Government of the Marshall Islands annual economic statistics tables, and annual SOE audit reports; Government of Solomon Islands, Ministry of Finance; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of Mauritius, Office of Public Sector Governance; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

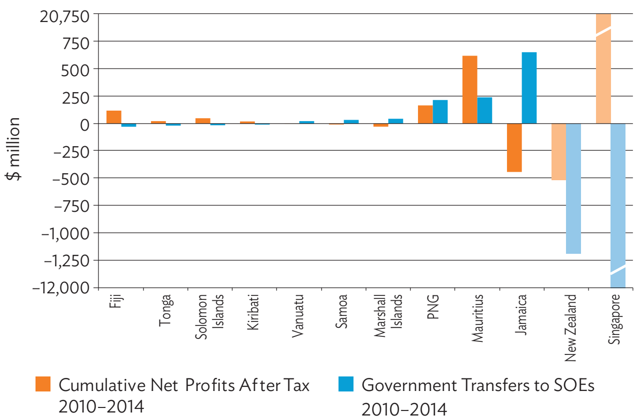
D. FISCAL IMPACT

Infrastructure SOEs are often forced to provide services on noncommercial terms. These subsidized activities, also known as CSOs, focus on delivering services to remote populations or providing services at reduced prices to selected customer groups. If properly contracted and funded, delivering these CSOs should not reduce the SOEs' profitability. The reality, however, is that CSOs are haphazardly imposed, poorly costed, and generally underfunded. These CSOs depress SOE profitability, contribute to inefficient resource allocation, and impair the government's ability to assess whether the CSOs provide value for money or achieve the outcomes sought.

SOEs benefit from ongoing government equity contributions. These are typically provided to finance assets, working capital, retire debt, and absorb accumulated losses to allow SOEs to function. Six of 10 developing countries in our sample require ongoing government support (Figure 4). This both distorts their economies and contributes to fiscal deficits.

The majority of countries with cumulative net losses from 2010 to 2014 require ongoing government contributions. However, in two countries (PNG and Mauritius), aggregate SOE portfolio net profits were positive, but still required government

Figure 4: Total Government Transfers to State-Owned Enterprises vs. Total State-Owned Enterprise Net Profits, FY2010–FY2014



FY = fiscal year, PNG = Papua New Guinea, SOE = state-owned enterprise, vs. = versus.

Sources: Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism; Government of Tonga, Ministry of Public Enterprises; Government of Solomon Islands, Ministry of Finance; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; Government of Vanuatu, Department of Finance and Treasury; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of the Marshall Islands annual economic statistics tables; Government of PNG, Kumul Consolidated Holdings; Government of Mauritius, Office of Public Sector Governance; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

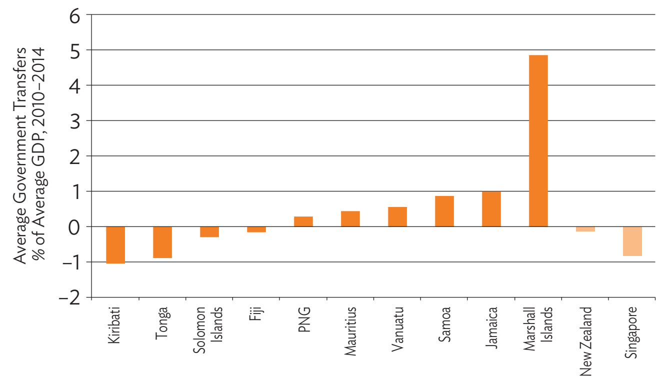
contributions. For countries where ongoing government contributions are required, the contributions are equivalent to 0.3%–4.8% of GDP (Figure 5).

In only five countries did SOE net profits exceed the value of government transfers in 2010–2014.[3] In four of these countries, cumulative net profits from SOEs allowed for dividend payments to government.

SOEs can be major contributors to macroeconomic instability. Loss-making SOEs create an ongoing strain on public finances. Jamaica, which is among the poorest-performing SOE portfolios in our benchmarking sample, had the highest level of government debt to GDP in 2014 (137%). The Marshall Islands, with by far the highest level of government transfers to SOEs as a percentage of GDP, also has one of the highest levels of government expenditure to GDP (Figure 6).

Ongoing investment in underperforming SOEs has both direct and indirect costs to the economy. By investing scarce resources in inefficient and loss-making public enterprises, they drain funds away from social sectors. During 2010–2014, the

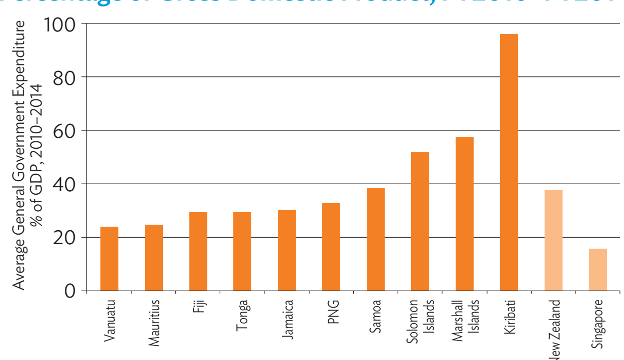
Figure 5: Average Government Transfers to State-Owned Enterprises as a Percentage of Average Gross Domestic Product, FY2010–FY2014



GDP = gross domestic product, FY = fiscal year, PNG = Papua New Guinea.

Sources: World Bank. World Development Indicators. http://databank.worldbank.org/data/home.aspx; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; Government of Tonga, Ministry of Public Enterprises; Government of Solomon Islands, Ministry of Finance; Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism; Government of PNG, Kumul Consolidated Holdings; Government of Mauritius, Office of Public Sector Governance; Government of Vanuatu, Department of Finance and Treasury; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of the Marshall Islands annual economic statistics tables, and annual SOE audit reports; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

Figure 6: Average General Government Expenditure Percentage of Gross Domestic Product, FY2010–FY2014



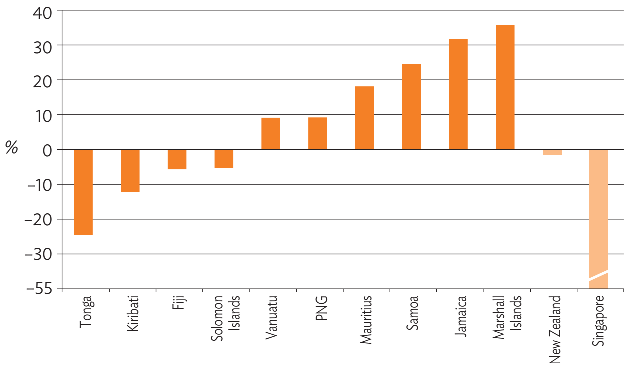
GDP = gross domestic product, FY = fiscal year, PNG = Papua New Guinea.

Sources: International Monetary Fund; World Bank. World Development Indicators. http://databank.worldbank.org/data/home.aspx

value of government transfers to SOEs ranged from 9% to 36% of government expenditure on public health services (Figure 7). It is an important indicator of the choices that governments make when propping up loss-making SOEs.

3 Fiji, Kiribati, Mauritius, Solomon Islands, and Tonga.

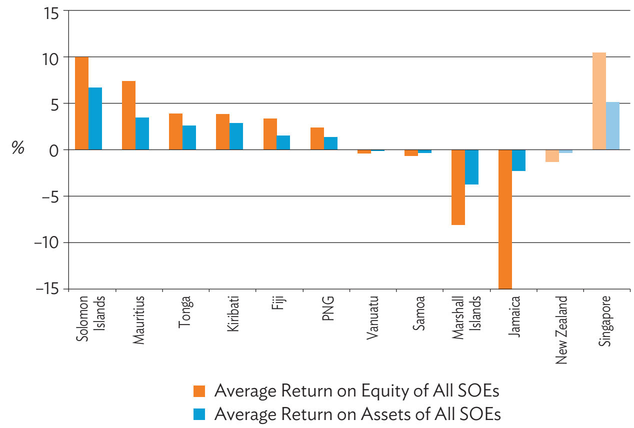
Figure 7: Cumulative Government Transfers to State-Owned Enterprises as Percentage of Total Public Health Expenditure, FY2010–FY2014



FY = fiscal year, PNG = Papua New Guinea.

Sources: World Bank. World Development Indicators. http://databank.worldbank.org/data/home.aspx; Government of Tonga, Ministry of Public Enterprises; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism; Government of Solomon Islands, Ministry of Finance; Government of Vanuatu, Department of Finance and Treasury; Government of PNG, Kumul Consolidated Holdings; Government of Mauritius, Office of Public Sector Governance; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of the Marshall Islands annual economic statistics tables, and annual SOE audit reports; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

Figure 8: Average Return on Equity and Return on Assets of State-Owned Enterprise Portfolios, FY2010–FY2014



FY = fiscal year; PNG = Papua New Guinea, SOE = state-owned enterprise.

Sources: Government of Solomon Islands, Ministry of Finance; Government of Mauritius, Office of Public Sector Governance; Government of Tonga, Ministry of Public Enterprises; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism; Government of PNG, Kumul Consolidated Holdings; Government of Vanuatu, Department of Finance and Treasury; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of the Marshall Islands annual economic statistics tables, and annual SOE audit reports; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

E. STATE-OWNED ENTERPRISE FINANCIAL PERFORMANCE

The financial performance of most SOE portfolios is weak. While the financial performance of most of the SOE portfolios improved in 2010–2014 compared with the 2002–2009 period, the average return on assets (ROA) and return on equity (ROE)[4] are still below the returns that would be expected by private sector investors for comparable business risk (Figure 8, Table 2). The exception is Solomon Islands, which averaged 10% ROE and 6.7% ROA, following the restructuring and recapitalization of its SOEs. Empirically, this was on par with the performance of Singapore's SOEs.

With the exception of PNG and Samoa, SOE asset utilization in all of the developing countries improved in 2010–2014 compared with the previous 2002–2009 period. Asset utilization is a component of ROA and ROE and shows how efficient assets are in generating sales. While acknowledging that other factors, such as productivity and gearing, are important, for the majority of SOEs, increasing asset utilization generally leads to improving ROA and ROE. The converse is generally also true.

ROA is improving for the majority of developing countries in our sample. There is an upward trend in the average profitability of 7 of the 10 SOE portfolios since 2010: Fiji, Jamaica, Kiribati, the Marshall Islands, Mauritius, Solomon Islands, and Tonga.[5] Commercialization is a contributing factor. The turnaround in Solomon Islands has been dramatic, with the portfolio surging from an average ROA of (4%) in 2002–2009 to 6.7% in 2010–2014 (Table 2). Solomon Islands portfolio's ROE in 2014 was 9.2%, the highest among the countries surveyed. This turnaround resulted from financial restructuring of the largest SOEs, improved collections, and renewed efforts to implement the SOE Act requiring SOEs to operate on strict commercial principles.

[4] Both ROA and ROE are important indicators of how efficiently SOEs use their capital resources, but differ depending on how much debt is used to finance operations.

[5] Jamaica, the Marshall Islands, and Vanuatu are improving but returns are still negative.

Table 2: State-Owned Enterprise Portfolio Profitability Indicators

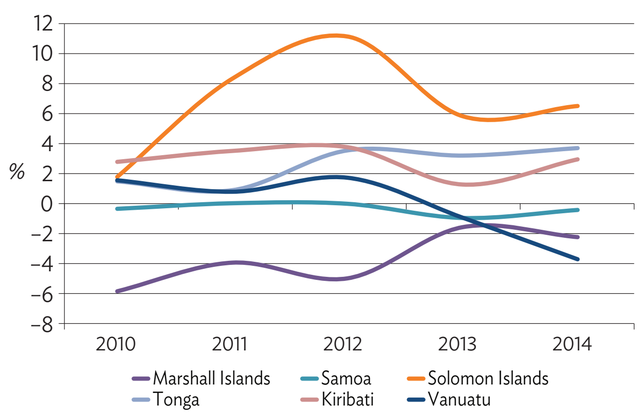
Country	Average Return on Assets (%)			Average Return on Equity (%)			Asset Utilization (%)		
Year	FY2002–FY2009	FY2010–FY2014	FY2002–FY2014	FY2002–FY2009	FY2010–FY2014	FY2002–FY2014	FY2002–FY2009	FY2010–FY2014	FY2002–FY2014
Tonga	3.8	2.6	3.3	6.4	3.9	5.5	29.0	36.0	32.0
PNG	3.9	1.3	2.9	6.7	2.4	5.0	63.0	47.0	57.0
Kiribati	NA	2.8	NA	NA	3.8	NA	NA	32.0	NA
Marshall Islands	(5.8)	(3.7)	(5.0)	(13.0)	(8.1)	(11.1)	40.0	52.0	45.0
Mauritius	1.0	3.4	1.9	2.6	7.4	4.5	56.0	70.0	62.0
Fiji	0.5	1.5	0.9	1.0	3.3	1.9	39.0	39.0	39.0
Solomon Islands	(4.3)	6.7	(0.1)	(13.0)	10.0	(3.2)	74.0	86.0	79.0
Samoa	0.1	(0.3)	(0.0)	0.2	(0.6)	(0.1)	31.0	20.0	27.0
Vanuatu (2010–2013)	NA	0.8	NA	NA	3.7	NA	NA	34.0	NA
Jamaica	(3.2)	(2.3)	(2.8)	(26.4)	(15.1)	(21.3)	60.0	67.0	63.0
New Zealand	NA	(0.4)	NA	NA	(1.3)	NA	NA	20.0	NA
Singapore	NA	5.1	NA	NA	10.4	NA	NA	43.0	NA

( ) = negative, FY = fiscal year, NA = not available, PNG = Papua New Guinea.

Notes: Return on assets is calculated as net profit after tax over total assets. Return on equity is calculated as net profit after tax over total equity. Asset utilization is calculated as total sales over total asset.

Sources: Government of Tonga, Ministry of Public Enterprises; Government of PNG, Kamul Consolidated Holdings; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; Government of the Marshall Islands annual economic statistics tables, and annual SOE audit reports; Government of Mauritius, Office of Public Sector Governance; Government of Fiji, Ministry of Public Enterprises Communications, Civil Aviation and Tourism; Government of Solomon Islands, Ministry of Finance; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of Vanuatu, Department of Finance and Treasury; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

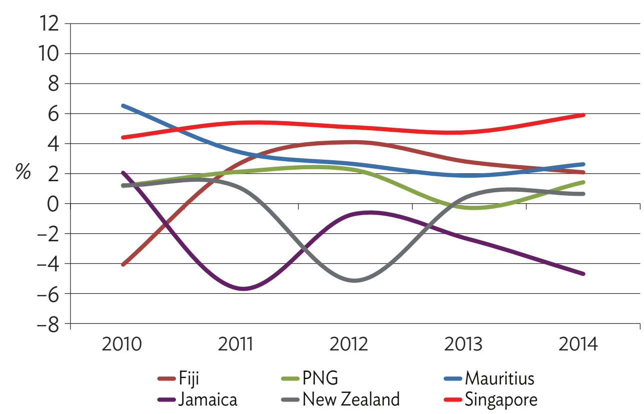
Figure 9: Average Return on Assets of State-Owned Enterprise Portfolios, GDP < $2 Billion, FY2010–FY2014



FY = fiscal year, GDP = gross domestic product.

Sources: Government of the Marshall Islands annual economic statistics tables, and annual SOE audit reports; Government of Samoa, State-Owned Enterprise Monitoring Unit; Government of Solomon Islands, Ministry of Finance; Government of Tonga, Ministry of Public Enterprises; Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development; and Government of Vanuatu, Department of Finance and Treasury.

Figure 10: Average Return on Assets of State-Owned Enterprise Portfolios, GDP > $2 Billion, FY2010–FY2014



FY = fiscal year, PNG = Papua New Guinea.

Sources: Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism; Government of PNG, Kumul Consolidated Holdings; Government of Mauritius, Office of Public Sector Governance; Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning; Government of New Zealand, The Treasury; and Government of Singapore, Ministry of Finance.

F. STATE-OWNED ENTERPRISE PRODUCTIVITY

GDP growth is fundamentally driven by productivity, or how efficiently countries use their physical and human capital and labor inputs.[6] When productivity is low, countries are extracting few outputs per worker and dollar of investment, and this in turn inhibits economic growth. This publication tracks the financial performance of SOEs. However, financial results provide only a partial insight into the economic impact of SOEs. To gain a more complete picture, SOE productivity must also be assessed.

Productivity is a measure of the efficiency of production: the quantity of output of an enterprise relative to the inputs used to produce the output. Inputs consist of capital and labor plus a third factor: the skills and techniques used to organize and run the enterprise. A detailed analysis of 25 infrastructure SOEs in six Pacific countries revealed that, on average, Pacific SOEs use inputs of capital and labor only 20% as efficiently as producers of these outputs do in the United States (Box 1).[7] While some of the difference can be accounted for by differences in scale economies, most of the variance is due to lower efficiency.

Box 1: Measuring Productivity in Pacific State-Owned Enterprises

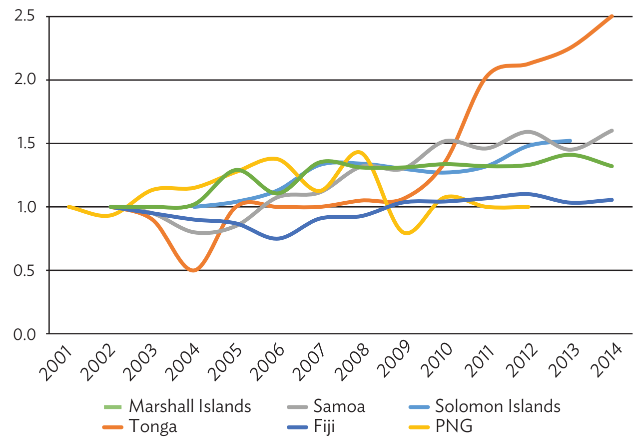
A productivity analysis was conducted on 25 state-owned enterprises providing power, water, port, and airport services in Fiji, Samoa, Solomon Islands, Tonga, PNG, and the Marshall Islands. Using data drawn from the 2001–2014 period, econometric techniques were used to calculate productivity performance both within country, cross country, and for specific industries. The analysis used revenue data because real outputs could not be obtained. This leads to the caution that, if prices are changed upwards frequently, price shocks could be misidentified as productivity shocks. In most cases in the sample, prices were relatively stable.

Source: Private Sector Development Initiative. Evaluation of Productivity of State-Owned Enterprises. Unpublished.

[6] "Productivity isn't everything, but in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to improve its output per worker." Paul Krugman. 1994. *The Age of Diminishing Expectations*. Massachusetts: MIT Press. p. 102.

[7] For the purposes of this analysis, SOEs in the United States are used as the productivity benchmark; this is not to suggest that Pacific SOEs could achieve the same levels of productivity, but rather to illustrate the gap between SOEs in small island economies and those in larger, advanced economies.

Figure 11: Average Total Factor Productivity Changes for Infrastructure State-Owned Enterprises, FY2001–FY2014



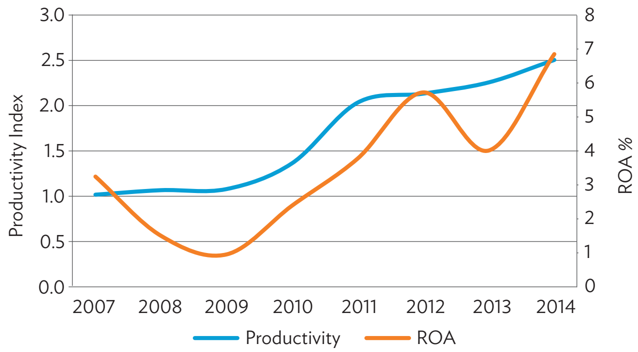
FY = fiscal year, PNG = Papua New Guinea.
Source: Private Sector Development Initiative analysis.

To raise their productivity, SOEs must improve their managerial capability, education and training of their workers, and quality and condition of their physical capital. This goes hand in hand with the efforts to commercialize, or operate under the same conditions as private companies. When SOEs are able to operate independently, with a clear commercial mandate and are held accountable for results, they are able to improve their productivity and competitiveness.

The analysis confirms that SOE productivity is improving in countries undertaking the most substantive reforms. Productivity improvements since 2002 have been most dramatic in Samoa, Solomon Islands, and Tonga, all three of which have introduced reforms to commercialize their SOEs. In Fiji and PNG, where reform has been least active, productivity improvements have been marginal.

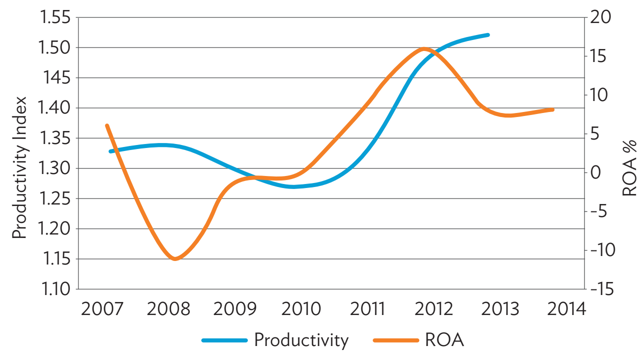
Since 2009, Tonga has implemented a broad-based SOE reform program, including the removal of ministers from SOE boards, adopting objective performance targets supported by improved transparency and accountability, robust CSO framework, contracting out noncore activities, and merging small nonprofitable SOEs to achieve economies of scale. Most of these reforms have impacted all SOEs including the four included in the productivity sample (Tonga Airports, Tonga Power, Tonga Ports, and Tonga Water Board), and have also produced sharp improvements in ROA (Figure 12). Tonga Water Board, which has had the most rapid improvement in productivity of the four, was also positively affected by improved collections.

Figure 12: Tonga Infrastructure State-Owned Enterprise Performance, 2007–2014



ROA = return on assets.
Source: Government of Tonga, Ministry of Public Enterprises.

Figure 13: Solomon Islands Infrastructure State-Owned Enterprise Performance, 2007–2014

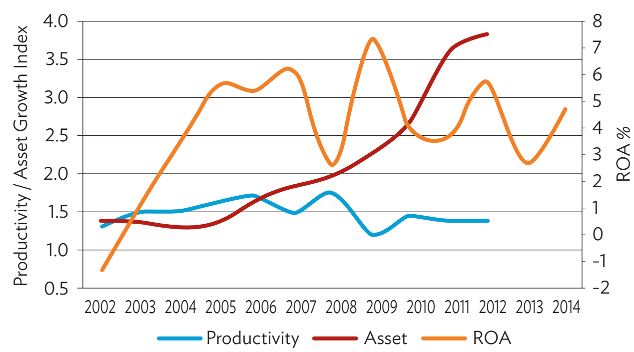


ROA = return on assets.
Source: Government of Solomon Islands, Ministry of Finance.

In Solomon Islands, similarly, reforms introduced since 2010 have allowed the power and water utilities to improve collections, charge commercial tariffs, and modernize their asset base, leading to improvements in both productivity and ROA (Figure 13).

In PNG, where SOE reform efforts have been more modest, productivity levels have largely stagnated. This is an important finding particularly in light of the rapid growth of capital investment in the SOE portfolio, with assets of the four SOEs included in the productivity survey growing threefold from a total book value of K0.8 billion in 2002 to K3.2 billion in 2014. Investment of this magnitude should result in large productivity improvements, but this has not occurred. While productivity has remained relatively static, the portfolio has experienced significant fluctuations in ROA, illustrating that financial performance can be driven by different factors than productivity, most notably when tariff levels are set at levels below, or well above, cost-recovery levels.

Figure 14: Papua New Guinea Infrastructure State-Owned Enterprise Performance, 2002–2014



ROA = return on assets.
Source: Kumul Consolidated Holdings.

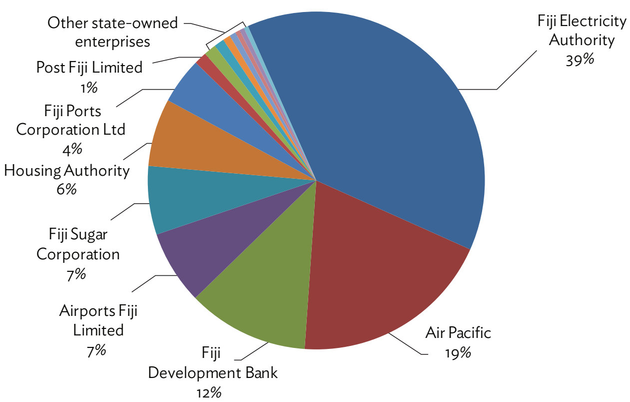
III. COUNTRY DIAGNOSTICS

A. FIJI

Fiji's SOEs have a substantial impact on the economy, providing most infrastructure services. The portfolio's profitability remains low, with an average return on equity (ROE) of 1.9% and return on assets (ROA) of 0.9% for 2002–2014. Portfolio profitability has increased markedly since 2010, with ROE peaking at 9.0% in 2012 and declining to 5.0% in 2014.[8] The improved performance resulted in an average ROE of 3.3% and an average ROA of 1.5% in the period 2010–2014. The improvement was largely driven by tariff increases, reduced fuel costs, and efficiency gains at the Fiji Electricity Authority (FEA), and by improved profitability at Fiji Airways,[9] Fiji Sugar Corporation, and Airports Fiji Limited (AFL). Despite this improved profitability, productivity within the 18 portfolio state-owned enterprises (SOEs) remains low. They contributed only 4% to gross domestic product (GDP) in 2014, despite controlling an estimated 12%–17% of total fixed assets in the economy.

Net government transfers to SOEs were down sharply in the 2010–2014 period, going from a net outflow of $53.6 million in 2003–2009 to a net inflow of $28.7 million in 2010–2014. This figure does not include other forms of government support such as guarantees on SOE borrowings and other financial support, estimated at F$1,218 million in 2014.[10]

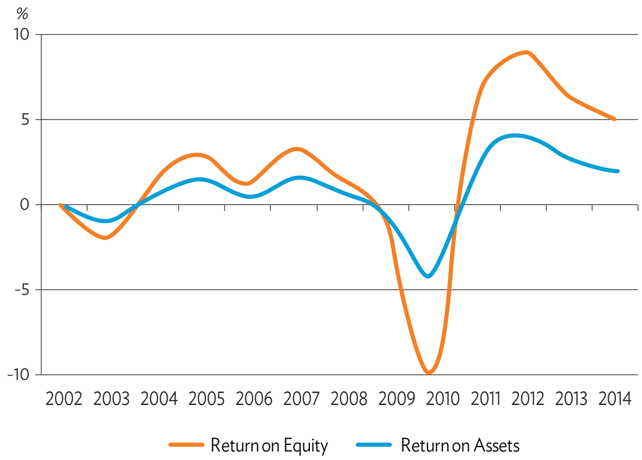
Figure 15: Fiji State-Owned Enterprise Portfolio Assets, FY2014 (F$2.9 billion)



F$ = Fiji dollar, FY = fiscal year.

Source: Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism.

Figure 16: Fiji State-Owned Portfolio Return on Equity and Return on Assets, FY2002–FY2014



FY = fiscal year.

Source: Government of Fiji, Ministry of Public Enterprises, Communications, Civil Aviation and Tourism.

Three SOEs dominate the portfolio. FEA, the Fiji Development Bank, and Fiji Airways accounted for 70% of total portfolio assets in 2014. Combined, they contributed 77.5% of total profits in 2014: Fiji Airways alone contributed 45%. Interestingly, three of the five best performing SOEs in the portfolio are those with a substantial private shareholding: Fintel (average ROE 2002–2012: 15.7%), Air Terminal Services (average ROE 2002–2014: 10.6%), Fiji Airways (average ROE 2002–2014: 10.2%). The private sector owned 49% of these three SOEs during the survey period, with Fintel being divested entirely in 2013.

Fiji has been reforming its SOEs for over 20 years. The 1996 Public Enterprise Act formalized the reform process. The government adopted a policy framework for SOE governance, management, and privatization in 2001, followed by a corporate governance framework in 2003. Fiji has been a regional leader in contracting out community service obligations (CSOs)

8 It should be noted that 2014 portfolio results do not include Fiji Hardwood, Fiji Pine, and Viti Corps Company Limited, as their 2014 financial accounts were not made available for this study.

9 Air Pacific trades as Fiji Airways.

10 F$146.5 million provided to Fiji Airways and Fiji Electricity Authority through the Fiji National Provident Fund (FNPF), F$833.6 million government guarantees and direct loans of F$238.1 million received by other SOEs. Source: Government of Fiji national budget documents for 2014 and 2014 SOE annual accounts.

to the private sector, and continues to seek opportunities to privatize other government functions.

Progress in commercializing SOEs has been patchy since 2006, as efforts lacked formal policy underpinnings. Criteria for selecting divestment candidates are unclear, and a broader program of SOE restructuring has yet to be developed. While the government has set revenue targets for SOE asset sales, it is proceeding cautiously to ensure that privatization of the larger infrastructure SOEs contributes to sector development and improvement of services. Recognizing that divestments to date have lacked a consistent and predictable process, the Ministry of Public Enterprises has committed to adopting a clear and transparent set of rules and procedures for SOE divestments. This will increase the attractiveness and lower the risk of future sales to private investors.

Since 2012, the government has completed five major divestments:

- 59% of Fiji Ports Corporation Limited (FPCL)[11]
- 51% of Ports Terminal Limited and a management contract for the Suva and Lautoka ports
- 51% of Fintel
- 100% of Fiji Dairy
- 50% of government's remaining 34.6% stake in Amalgamated Telecom Holdings

In addition, expressions of interest have been sought for the Government Printery and Stationery Department and FEA. Options for structuring these divestments as well as AFL are currently under consideration. The combined regulatory and commercial functions of a number of SOEs (including FEA and AFL), and their role in delivering CSOs, must be addressed prior to their divestment if the government is to maximize the value of their shares and influence broader sector development.

An improved legal and regulatory framework for public–private partnerships (PPPs) would facilitate future transactions. The 2006 PPP Act contains a number of provisions limiting foreign investment, and lacks clear guidelines for developing and transacting PPP projects. The ministry is currently updating this legal framework so that PPP projects can be more effectively prepared.

To strengthen SOE monitoring, the ownership monitoring team within the Ministry of Finance has been merged with the Ministry of Public Enterprises. Before January 2014, SOE ownership monitoring was divided between the Asset Management Unit in the Ministry of Finance and the Ministry of Public Enterprises (MPE). The Asset Management Unit was primarily responsible for the partially privatized SOEs, but there was significant duplication of activity with the MPE. Now that the merger is complete, ownership monitoring practices are improving, but the weakness of the 1996 Public Enterprise Act still frustrates the MPE's efforts.[12]

The Minister of Public Enterprises has committed to modernizing the Public Enterprise Act to facilitate monitoring and support the commercialization of SOEs. The proposed act will harmonize the forms of SOEs monitored by the MPE; make the Minister of Public Enterprises solely responsible for safeguarding the government's investment in the SOEs; clarify their commercial mandate; establish guidelines for the identification, costing, contracting, and financing of CSOs; and strengthen disclosure requirements and the process for selecting, appointing, and evaluating the performance of directors. This, together with a formalization of the authorities delegated by the minister to MPE staff, will help to improve monitoring effectiveness.

Improved ownership monitoring will eliminate the need for monitoring staff to sit as board observers. To deal with weaknesses in ownership monitoring and the lack of quality and timely information from the SOEs, ownership-monitoring staff sit as observers on SOE boards. This exposes the monitoring staff to conflicts of interest as they could be deemed directors, and it undermines the board's independence and accountability. The ministry has committed to phasing out this practice as SOE reporting improves.

Box 2: Privatization and Public–Private Partnerships in Fiji: Ports Terminal

In July 2013, the Government of Fiji partially privatized Ports Terminal Limited, selling 51% to Aitken Spence PLC of Sri Lanka and structuring an operations and management contract for the ports of Suva and Lautoka. According to Ports Terminal Limited, which provides cargo handling and stevedoring services, productivity at the ports has increased by 70% since 2013, vessel turnaround time has been reduced from 36 hours to 22 hours, and vessel berth waiting time has been reduced from six hours to one hour or less

[11] 59% of Fiji Ports was divested to the Fiji National Provident Fund] (39%) and Aitken Spence (20%) in November 2015.

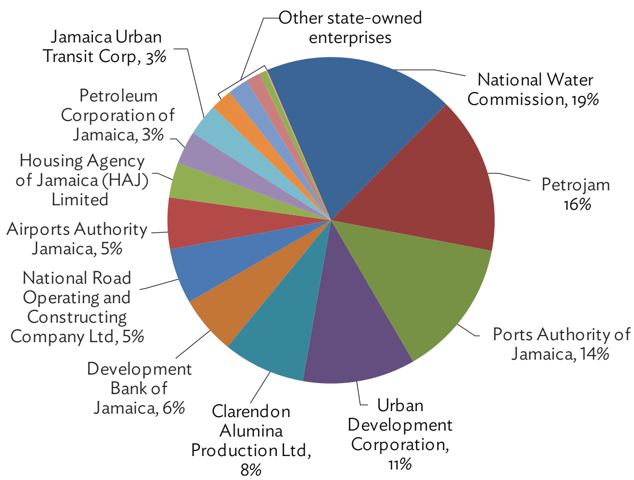
[12] See Appendix 4 for comparative review of the SOE Acts of the participating countries in this study.

B. JAMAICA

Jamaica has one of the most diversified SOE portfolios in the benchmarking sample.[13] SOEs operate in almost every sector of the economy, providing public transport, banking, airport, water, housing, ports, hotel, mining, and petroleum-related services. Two of the largest SOEs, Petrojam Limited[14] and the Port Authority of Jamaica, representing 30% of the total portfolio assets, contributed the bulk of the portfolio's positive earnings from 2003 to 2014. Jamaica has the highest proportion of noninfrastructure SOEs in the benchmarking sample, representing 59% of the total portfolio assets, and contributing 35% of the cumulative loss over 2003–2014. Many of these SOEs compete directly with the private sector, and their ability to continue operating at a loss distorts competition.

Accumulated losses by SOEs have been a major contributor to Jamaica's estimated $20 billion public debt (137% of GDP in FY2014). Only 10 of the 21 SOEs generated a net cumulative profit over 2003–2014, with the largest losses attributable to Air Jamaica,[15] National Road Operating & Constructing Company (NROCC), National Water Commission, Clarendon Alumina, and the Sugar Company of Jamaica. NROCC alone generated 35% of total portfolio losses from 2003 to 2014.[16] The average ROA of the 21 SOEs in 2003–2014 was (2.8%) and ROE was (21.3%).[17] The portfolio generated positive returns on assets and equity in just 2 years in the 2003–2014 period, 2003 and 2010. To absorb these losses and keep the SOEs operating, the government has injected almost $761 million of taxpayers funds,[18] roughly equivalent to 21% of the government's total spending on health, during 2003–2014. The SOE sector's low productivity has slowed economic growth, as illustrated by its low 0.3% contribution to GDP in 2014.[19]

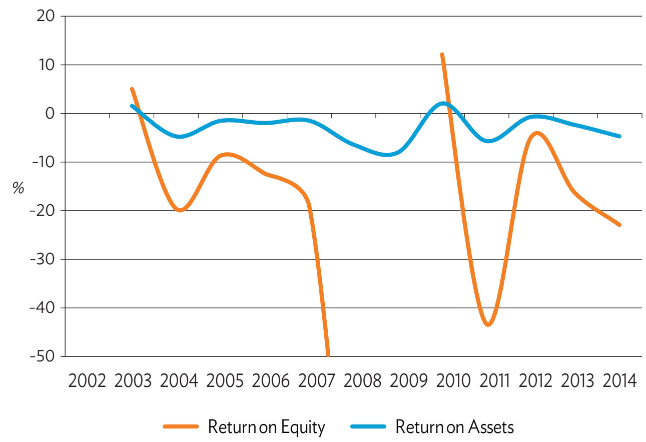
Figure 17: Jamaica State-Owned Enterprise Portfolio Assets, FY2014 (J$404 billion)



FY = fiscal year, J$ = Jamaican dollar.

Source: Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning.

Figure 18: Jamaica State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2002–FY2014



FY = fiscal year.

In this figure; the ROE of (104%) in FY2008 is not illustrated due to the limited scale of the chart; in FY2009, ROE cannot be calculated because portfolio equity was negative in that year.

Source: Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning.

13 It should be noted that the sample includes data gaps. 21 SOEs are covered in this benchmarking sample, although only in 2009 were the financial results of all 21 SOEs included in the calculations. In other years, the sample consisted of 17–20 SOEs due to changes in the composition of the portfolio (divestment and acquisitions) and the availability of financial accounts. In the case of the Sugar Company of Jamaica, for example, financial accounts were only available for 2003, 2007 and 2009.

14 Petrojam Ltd is 51% owned by Petroleum Corporation of Jamaica (PCJ), but is not consolidated as part of PCJ's accounts. Other PCJ subsidiaries' which are consolidated and not separately included in the portfolio are Petrojam-Ethanol Ltd, Petroleum Company of Jamaica Ltd and Wigton Windfarm.

15 If Air Jamaica was excluded, the portfolio average ROE 2003–2012 would be (9%).

16 NROCC manages the Government's interests in 2 toll road concessions, one of which is chronically loss-making, as the lower than projected traffic flows are yielding insufficient revenue to service the $-denominated debt obligations.

17 The 21 SOEs used in this benchmarking survey are a subset of the 195 entities known as "public bodies" in Jamaica. The 21 SOEs are the majority state-owned, for profit, and predominately self-financing entities.

18 This figure does not include all the amounts transferred to SOEs through the government forgiving debt owed or assuming SOEs' debt obligations to third parties, which are estimated to be substantial, but could not be obtained for this study.

19 The portfolio's contribution to GDP has increased in 2014 relative to 2012, when it was a −1.2%.

Portfolio performance improved in 2010–2014, largely as a result of the divestment of Air Jamaica. Average ROA of the portfolio was (2.3%) and ROE was (15.1%). If NROCC is excluded from the portfolio, average ROE for the period would have been (0.7%) and ROA (2.1%). While portfolio losses were down in 2010–2014, compared with earlier years, they still remain a substantial drain on public finances, one which the government has publicly resolved to address through an accelerated program of commercialization, restructuring, and privatization.

Jamaica has had a long history of SOE reform efforts, with mixed results. During the mid-1990 financial crisis, the government's rescue of failed financial institutions and the renationalization of previously privatized SOEs resulted in an expanded SOE portfolio. Some failed financial institutions were managed by or placed in Financial Sector Adjustment Company (FINSAC), a state-owned bank. Many of these SOEs were subsequently divested, adding to the total of 100 divestments[20] from 1980 to 2012. There were 22 full or partial privatizations from 1999 to 2013. While the number of privatizations appears impressive, the potential fiscal benefits were undermined by the ongoing poor performance of those SOEs that remained under government ownership. A fundamental weakness in the reform program has been the government's practice of underwriting failing and even privatized SOEs, creating an important moral hazard. The experience of Air Jamaica (Box 3) and FINSAC illustrates this point. If SOEs are to operate commercially, they must be allowed to fail.

The 2012 privatization policy provides an excellent basis for reform, but implementation requires broad cooperation across government. The Development Bank of Jamaica, responsible for implementing the privatization program since 2006,[21] has a pipeline of transactions comprising real estate assets, hotels, and SOEs. The full application of the policy would leave few SOEs under state control (Box 4). The pace of reform and divestment, however, has been slow, as resistance to SOE reform persists in many parts of government. Apart from the Petroleum Company of Jamaica Ltd(Petcom), currently being prepared for sale, Petrojam Ethanol, Factories Jamaica, and Wigton Wind Farms, most of the SOEs targeted for privatization remain small. To achieve the goals of the privatization policy and shore up chronic portfolio losses, the transaction pipeline should be broadened and the program accelerated, with support across the government. The planned partial privatization of SOEs through listings on the Jamaica Stock Exchange is a positive development that will not only generate revenues for the government, but also introduce disclosure and governance requirements in support of their commercial objectives.

Box 3: The Cost of Owning Air Jamaica

Air Jamaica was established in 1963 as a joint venture with British and Trinidadian state airways. After years of losses, the Government of Jamaica acquired the company in 1980, yet the airline continued to generate losses for most of the next 14 years. In 1994, the government sold 70% of the airline to Jamaican and Canadian investors for $26.5 million, reserving 5% for employees. The government retained 25% and responsibility for all accumulated liabilities. The following year, Air Jamaica made a small operational profit but the situation deteriorated again with total losses of $100 million in 1997 and in 1998, forcing fresh capital injections of $50 million and $80 million in those 2 years. The poor performance was attributed to operating restrictions imposed by the US Federal Aviation Administration and the airline's inability to increase efficiency and forge alliances with other carriers.

By 2004, liabilities to the government totaled close to $400 million and the airline was re-nationalized with a plan to reduce the $60 million–$70 million annual losses through restructuring and downsizing. Instead, the loss increased to over $100 million annually culminating in 2009–2010 at the equivalent of 1.8% of gross domestic product. In 2011, after a lengthy sales process, the government sold 84% of Air Jamaica to the Caribbean Airlines (CAL), the state-owned airline of Trinidad and Tobago. The government again retained responsibility for the accumulated debt of $940 million, as well as employee separation payments, air traffic liabilities, and contract termination payment, totaling an additional $148 million.

Despite subsidized fuel from the Government of Trinidad and Tobago, CAL continues to lose money on its Air Jamaica routes. CAL cannot compete with the 20 airlines that service Jamaica, including Air Canada, US Airways, British Airways, American Airlines, and low-cost carriers. The history of Air Jamaica illustrates the high risk of maintaining a state-owned airline. During its 50-year life, the airline has cost the Jamaican taxpayer an estimated $1.5 billion (equivalent to 12% of gross domestic product in 2009–2010).

Jamaica has and is pursuing PPPs for the provision of infrastructure services, leveraging much-needed private investment and relieving the government of operating risk. Concession agreements are under development for the Norman Manley Airport and the Port of Kingston, involving a total investment of over $500 million. A PPP is already in place

[20] These divestments include the sale of government agencies, noncorporatized assets, and SOEs.

[21] The National Investment Bank of Jamaica was the implementing agency for the privatization program from 1991–2006.

Box 4: Main Precepts of the Privatization Policy of the Government of Jamaica

Main Precepts:

- Secure greater efficiency and competitiveness in the state-owned enterprises' operations
- Reduce the drain on fiscal resources of the Government of Jamaica
- Strengthen the government's fiscal and debt management program
- Accelerate the transfer of capital, technology, and management procedures
- Widen the ownership base
- Maximize efficiency in providing public services through outsourcing–to deliver greater value for money

Targeted Assets:

- Those that form no part of the government's core service obligations
- Those not being used to provide social goods and services
- Those that can be more efficiently developed and operated with private capital and under private management
- Those that unnecessarily burden taxpayers
- Those needed to provide public services that private firms can operate more efficiently, supplying services under contract to the government

at Jamaica's largest airport in Montego Bay. In the roads sector, however, the concession agreement for Highway 2000 has proved to be financially burdensome for the government, with NROCC's US dollar-denominated liabilities increasing 23% due solely to currency depreciation, coupled with lower-than-expected traffic flows and high level of demand risk carried by the SOE. The NROCC PPP illustrates the importance of effective risk allocation in PPPs. Given Jamaica's continued infrastructure investment needs, PPPs remain a very useful mechanism for attracting private investment and expertise, but only if the transactions are prepared transparently, competitively tendered, and subject to rigorous fiscal risk assessments. Jamaica continues to make improvements to its regulatory framework for PPPs, and was recently ranked 8th out of 18 countries in Latin America and the Caribbean for its PPP readiness.[22]

[22] Economist Intelligence Unit. 2014. *Evaluating the environment for public–private partnerships in Latin America and the Caribbean: The 2014 Infrascope.*

In September 2015, the government—with support from the International Monetary Fund (IMF)—launched a review of the public bodies sector, which will include a wholesale stregthening of the SOE legislative framework. The primary SOE law, the Public Bodies Management & Accountability Act 2001 (PBMA Act),[23] is deficient in important areas, most notably: (i) there is no primary objective that requires the SOEs to operate commercially,[24] (ii) there are no provisions dealing with CSOs, and (iii) there is no statement establishing the role of SOE directors and how and for what they are held to account. The only commercial imperative in the PBMA Act is that the board must take "such steps as are necessary for the efficient and effective management of the public body." Recent amendments and regulations[25] made pursuant to the PBMA Act have attempted to create more autonomy and accountability for "commercial" SOEs, but restrictive criteria means that very few SOEs would qualify as "commercial." The PBMA Act and regulations include useful monitoring requirements, although actual practice falls short of the statutory requirements with delays in the production of SOE interim reports and audited financial statements.[26] The public bodies review provides an opportunity to address these key weaknesses.

The current governance arrangements do not support the commercial management of the SOEs. The minister responsible for an SOE is the minister responsible for the sector within which the SOE operates and, as such, has a significant conflict of interest, being the purchaser of the SOEs' outputs and the sector regulator. The sector minister is motivated to encourage the SOE to provide maximum goods and/or services at the lowest price or cost to the beneficiary, while a rational owner would focus on achieving an acceptable financial return to compensate for risk and to ensure the SOE's long-term organizational health. The responsible ministers' focus on the former over the latter largely explains the poor performance of Jamaica's SOEs.

The Public Enterprise Division (PED) within the Ministry of Finance manages the oversight of Jamaica's SOEs in partnership with sector ministries.[27] The sector ministries support their "responsible minister," particularly in making director appointments and approving SOE corporate plans.

[23] The PBMA Act was amended in 2010, 2014, and 2015.

[24] The 2012 and 2015 PBMA regulations set dividend targets but fall short of requiring SOEs to operate profitably.

[25] PBMA Amendment Act 2014, PBMA Amendment Act 2015, PBMA Regulations 2015, Financial Administration & Audit Regulations 2015.

[26] Based on responses to the questionnaire sent by the Asian Development Bank (ADB) to all relevant sector ministries and the Ministry of Finance. In 2013, less than 50% of SOEs produced annual reports within the time frame set in the PBMA Act.

[27] The PED was established in 1982 and restructuring commenced in 2012. Currently, it monitors 82 out of the 195 public bodies in Jamaica.

For the same reasons that sector ministers have a conflict of interest in overseeing the government's ownership interest in SOEs, so too do the sector ministries. Establishing a central SOE ownership monitor—which could be a strengthened PED, reporting to a minister of SOEs—would enhance the government's ownership oversight.

The Corporate Governance Framework for Public Bodies in Jamaica, introduced in 2011 and amended in 2012, provides a strong basis for strengthening governance practices. The framework was developed to address the weaknesses in SOE governance, but the absence of a central ownership monitor has resulted in patchy implementation. The Ministry of Finance has identified improved governance practices as a key driver for improved SOE performance, and the development of a Competency Profile Instrument for Boards and Code of Conduct for Directors in 2015 will assist in these efforts. Other useful measures include the development of a database of corporate directors who could serve on SOE boards; the adoption of a skills-based director selection process; and greater clarity in the role and responsibility of ministers, boards, and management.

The broad fiscal reforms spurred by the debt crisis provide an opportunity to fundamentally restructure the SOE portfolio, identify assets for divestment and place those that remain under public ownership on an unambiguous commercial footing. This will require further legislative amendments, but most importantly, a broad political consensus for action. Specific measures should include:

- Requiring all SOEs to operate under a well-defined and transparent commercial mandate, with operating autonomy and accountability for results,
- Registering commercial SOEs as companies under the Companies Act,[28]
- Introducing a CSO framework to fully and fairly compensate SOEs for CSOs they are required to undertake,
- Incentivizing government to contract the provision of CSOs directly with the private sector where appropriate,
- Establishing a central SOE ownership-monitoring agency or ministry, reporting to a minister responsible for all SOEs, and
- Implementing the Corporate Governance Framework for Public Bodies.

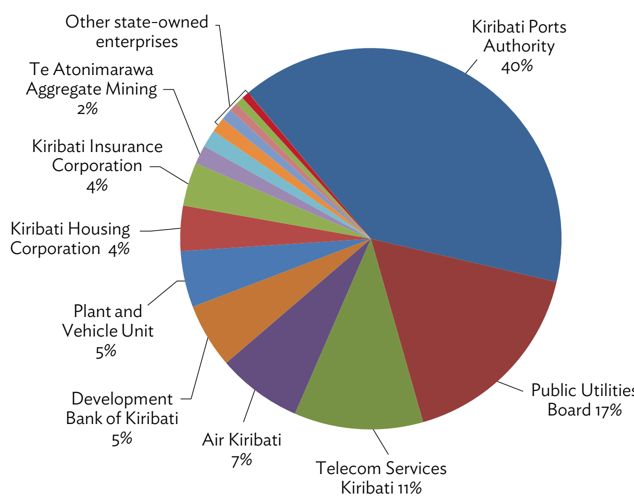
[28] In 2015, 8 out of the 21 SOEs in the benchmarking sample were not registered under the Companies Act.

C. KIRIBATI

Kiribati has 16 active SOEs involved in a range of commercial activities including utilities, transport, communication, and finance. In 2014, these SOEs represented 18% of the total capital stock of the country and contributed 12% to the GDP. While small relative to the size of the state's investment, this contribution is the highest of all countries in the study. It appears this is driven by the comparatively high level of SOE salary and wages as a proportion of GDP. The financial results of the SOE portfolio must be treated with some caution, however, as few of the SOEs received unqualified audit reports.

The SOE portfolio achieved an average ROE of 3.8% and ROA of 2.8% for 2010–2014. Six SOEs comprise 85% of the total portfolio assets of A$175.8 million, with Kiribati Port Authority (KPA) representing almost 40%. The other SOEs making up the six largest are Air Kiribati, the Public Utilities Board (PUB),[29] Telecom Services Kiribati (TSK), Development Bank of Kiribati and the Plant & Vehicle Unit. Financial performance within these SOEs is mixed. During the 2010–2014 period, KPA, the Plant & Vehicle Unit, and TSK generated more than 120% of the portfolio's total net profit. The strongest performer in 2010–2014 was TSK, achieving an average ROE of 15.1%—the highest return by a telecommunication SOE among participating countries.

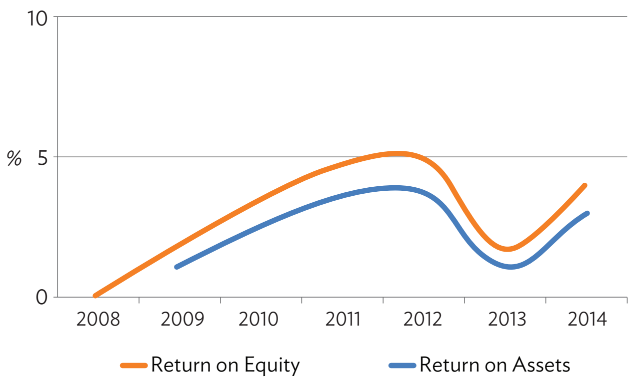
Figure 19: Kiribati State-Owned Enterprise Portfolio Assets, FY2014 (A$178 million)



FY = fiscal year, A$ = Australian dollar.
Source: SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development.

[29] Combined power and water utility.

Figure 20: Kiribati State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2008–FY2012



FY = fiscal year.

Source: Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development.

Accepting that the company's gearing is an unsustainable 90%,[30] its average ROA is still comparatively high at 6.8%. The performance of Air Kiribati has steadily declined since 2008 and now operates with negative gearing—debt exceeds equity 1.5 times. The company's ROE for 2014 was (20%)—the lowest among this group. At the other extreme, KPA with no debt achieved an average ROE of 4.8% in 2010–2014. Rounding off the group of five, PUB's average ROE was (6.3%) in 2010–2014, increasing borrowings over the period to finance losses.

Prior to 2009, the government had little knowledge of the SOEs' financial position and their operations. While the financial data supplied by the SOE monitoring unit in Kiribati place SOE performance in the midrange of the countries participating in this study, the accounts must be treated with caution. Little or no financial information is available for the period prior to 2008, and FY2014 will be the first year that many SOEs will produce audited and compliant financial reports.

SOE reform has been underway since 2009 and includes a range of legal, institutional, and company-specific measures. The reform framework is based around the 2012 SOE Act. Prior to the reforms, there was no effective monitoring and minimal accountability. The government provided nontransparent and nonaccountable subsidies to prop up SOEs, there was no forward planning, and ministers directed SOEs to undertake noncommercial activities and would dismiss directors when they failed to accommodate their requests. Major reforms initiated since 2009 include

- sale of the Kiribati Supplies Company Limited, Bobotin Kiribati Limited and Telecom Services Kiribati,[31]
- completion of the concession for Otintaai Hotel Limited in 2013,[32]
- development of reform and restructuring strategies which were then progressively implemented for all SOEs,
- timely production of audited accounts,
- establishment of an SOE monitoring unit within the Ministry of Finance,
- adoption of a form of skills-based director selection and appointment process and director training, and
- preparation of business planning documents.

A concession[33] for the Betio Shipyards Limited is expected to be completed in the first quarter of 2016.

Despite the broad reforms undertaken since 2009, there has been no real improvement in overall portfolio profitability. The performance of the five largest SOEs—comprising 76% of portfolio total asset—has changed little since 2010, suppressing overall portfolio returns. Net losses of A$5 million at the PUB in 2013 brought portfolio profitability down to A$1.8 million from A$5 million the previous year. Performance of the balance of the SOEs has been volatile: ROE for some swinging by over 100%. The government guaranteed $10.4 million of SOE debt in 2014, representing 33.4% of total SOE debt. The sale of TSK's business to Vodafone Fiji in May 2015, at a price higher than expected, allowed the government to clear $8.0 million of the outstanding guarantees.

The Kiribati SOE monitoring unit has identified lack of funding for CSOs as a major issue undermining improved SOE performance. The lack of adequate compensation for CSOs contributes to the flat trend in portfolio profitability. While the SOE Act requires CSOs to be properly documented, and a price agreed with the government, it does not stipulate that the price should allow SOEs to fully recover costs, including the cost of capital. The SOE Act also stipulates that SOEs

30 Average debt to equity ratio during 2010–2014.

31 Kiribati Supplies Company Limited was sold in 2012; Bobotin Kiribati Limited assets were sold in 2015, SOE to be liquidated; and Telecom Services Kiribati's business was purchased by Vodafone Fiji in May 2015, and the SOE will be liquidated.

32 Concession involves a management contract requiring successful tender to make capital contributions for refurbishment.

33 Form of concession contract requiring contractor/operator to contribute capital for refurbishment.

Box 5: Strengthening the Kiribati State-Owned Enterprises Act

While the State-Owned Enterprise (SOE) Act is generally sound, it has two major weaknesses: absence of a clear commercial mandate for the SOEs, and sector minister involvement in SOE operations.

1. The SOE Act requires SOEs to operate as a successful and sustainable business which is defined as "a business that is as efficient and effective as a comparable business that is not owned by the state and services its debts without payments from the government."[a] This is a very low threshold and is unlikely to drive improved performance. It will also make it difficult for SOEs to recover the full cost of CSOs—the government need only fund to the point where the SOE can "service its debts."
2. The sector or line minister is appointed as the responsible minister for SOEs that operate within his or her sector. This creates a significant conflict of interest as it confuses regulation and purchase with ownership.

CSOs = community service obligations.
[a] State-Owned Enterprise Act 2012, s5.

cannot refuse to undertake a CSO. Seven SOEs[34] lodged CSO claims totaling $7 million in 2013 for the 2014 fiscal year. Despite the Government of Kiribati allocating $4.5 million in the 2014 budget to fund CSO, by October 2015 only $0.9 million had been paid.

The monitoring unit has identified several reform priorities: (i) continued rationalization of the SOE portfolio, (ii) development of a pool of qualified SOE director candidates, and (iii) strengthening the SOE Act. Suggested amendments include: (i) requiring SOEs to earn a commercial return, (ii) consolidating SOE ownership responsibility in a single minister, and (iii) stipulating that SOEs should be fully funded for the CSOs they are required to undertake.

Continued implementation of the SOE Act as a whole should have a direct impact on improving SOE performance in Kiribati, and this should be accompanied by continued divestment and outsourcing of SOE activities to the private sector. Kiribati's experience since 2009 illustrates the positive impact SOE reform can have on improved SOE efficiency and public finances.

[34] The largest claims were lodged by Kiribati Housing Corporation ($1.45 million), Kiribati Oil Company Limited ($2.7 million), and Public Utilities Board ($2.2 million).

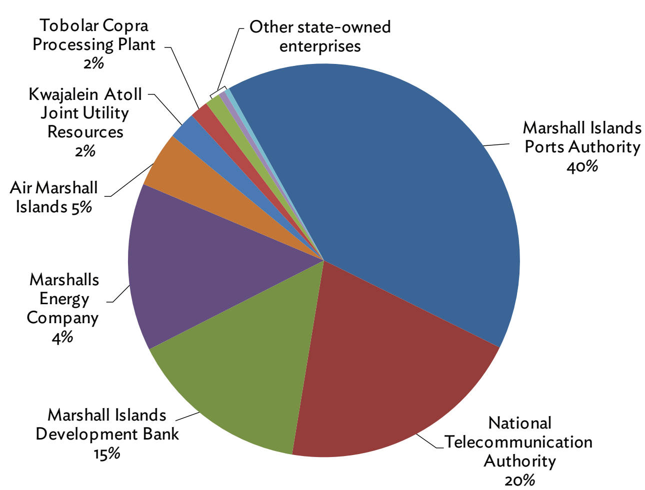
D. MARSHALL ISLANDS

The Marshall Islands has 11 active SOEs involved in a range of commercial activities including utilities, transport, banking, telecommunication, and hotels. In 2014, these SOEs represented 17%–20% of the total capital stock of the country yet contributed only 5.3% to GDP.

The Marshall Islands' SOE portfolio generated losses each year from 2002 to 2014, with an average ROA of (5.0%) and ROE of (11.1%). While portfolio profitability is steadily improving—from ROA of (5.8%) and ROE of (13.0%) from 2002 to 2009, to ROA of (3.7%) and ROE of (8.1%) in 2010–2014—the SOEs remain a significant drain on the national budget. Four large SOEs dominate the portfolio: Marshall Islands Ports Authority, National Telecommunications Authority, Marshall Islands Development Bank (MIDB), and Marshall Energy Company (MEC), representing 89% of total SOE assets with the Ports Authority alone accounting for 40%. Only 3 of the 11 SOEs in the portfolio produced positive returns in 2014: MIDB, MEC, and the Marshall Islands Shipping Corporation.

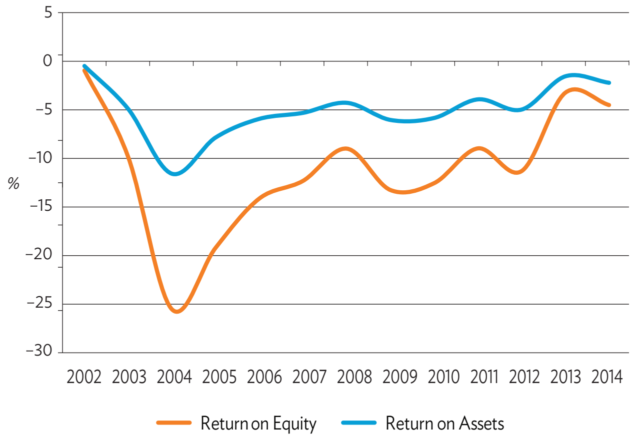
MIDB remains the standout performer, achieving an average ROE of 4.7% for 2002–2014. Its comparatively better financial performance is due to the bank's focus on higher margin consumer lending. After recording a small loss in 2013 due to a significant increase in the provision for loan losses, MIDB returned to historic profit levels in 2014 with an ROE of 11.4%.

Figure 21: Marshall Islands State-Owned Enterprise Portfolio Assets, FY2014 ($165 million)



FY = fiscal year.
Sources: Government of the Marshall Islands annual state-owned enterprise audit reports and annual economic statistics tables.

Figure 22: Marshall Islands State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2002–FY2014



FY = fiscal year.
Sources: Government of the Marshall Islands annual state-owned enterprise audit reports and annual economic statistics tables.

Box 6: Marshall Energy Company Pioneers Renewable Energy Public–Private Partnership

The Marshall Energy Company's (MEC) new General Electric (GE) clean cycle units began operating in the third quarter of 2015. GE financed the entire $2.4 million cost of equipment and installation, which also involved MEC power plant engineers. Under the terms of the public–private partnership, the MEC will pay GE 85% of the fuel savings up to a maximum of $20,000 per month for the next 10 years. A key element of the deal is GE is guaranteeing performance of the system, with financial benefits to the Majuro utility if it underperforms. The units are expected to generate about 1.6 million kilowatt hours per year, which translates into potential electricity revenue of $725,000 a year. This should result in reducing fuel use at the power plant of up to 100,000 gallons a year, a savings of over $300,000 at current fuel prices.

Source: *Islands Business*, 8 October 2014.

The Marshall Energy Company has also been a comparatively strong performer since 2012 following the board's adoption of a comprehensive recovery plan. The plan aims to (i) strengthen governance, (ii) improve organizational policies, and (iii) improve company finances. Indications are that the plan has been effective. MEC's operating losses were pulled back from $1.7 million in 2010 to a profit of $2.2 million in 2013, although the company returned to breakeven in 2014. The reduced profit was driven by lower electricity sales and an increase in doubtful debts. In October 2014, the company announced that it had entered into a PPP with GE Heat Recovery Solutions to install and operate two 280 kilowatt clean cycle heat to power units (Box 6). The units will allow MEC to reduce its dependence on diesel, the primary source of fuel for electricity generation, without needing to make a large initial capital investment. This transaction illustrates one of the key benefits of PPPs, leveraging private capital to introduce new technologies.

The improved portfolio performance has also been assisted by the largest SOE, Marshall Islands Ports Authority (MIPA). Unique among comparative port companies, MIPA also owns and operates the airport on Majuro. The airport has tended to be the poorer performer of the company's two main operations, but both experienced improved results in 2014, with net operating revenue 135% higher than in 2013. The improvement was driven by increased revenues resulting from a higher volume of flights landing at the airport and increased ship visits, mainly fishing vessels, into the port. While these improvements are notable, MIPA has recorded net losses every year since 2006.

SOEs are sustained by a high level of government transfers—$43.9 million in 2010–2014—and access to significantly discounted debt. Average government transfers to SOEs during 2010–2014 were equivalent to 4.8% of average GDP, the highest in the benchmarking sample. Government transfers declined in the 2010–2014 period in line with the slightly improved SOE performance: government transfers in 2003–2014 totaled $107.3 million and were 5.7% of average GDP. The gap between commercial loan rates and the rates SOEs paid on their debt averaged 7.7% in 2010–2014, an increase of 2.5% over the average in 2002–2014. The subsidized cost of borrowing enjoyed by the Marshall Islands SOEs is the third highest in the benchmark sample. The negative ROE and high level of ongoing government contributions drains money from much needed social services such as health and education. The net transfers paid to SOEs equate to 36.2% of the total public expenditure on health in 2010–2014.

The passage of the new SOE Act in October 2015 sets the stage for the commercialization of the SOEs, but has already been weakened by an amendment allowing elected

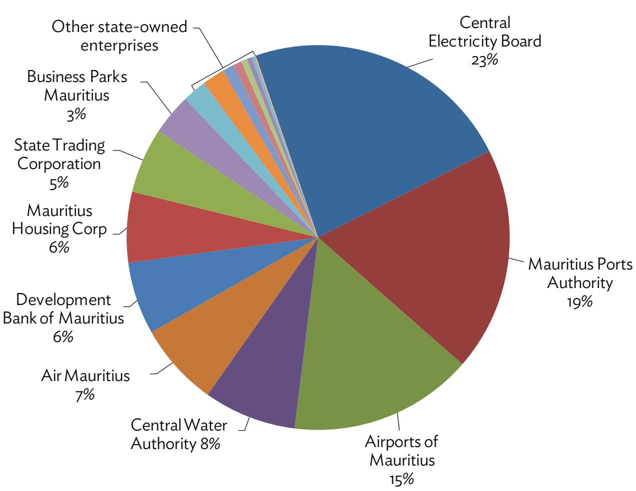
officials[35] to remain on SOE boards. If SOEs are to succeed as commercial businesses, as required by the SOE Act, this amendment must be repealed. Implementation of the SOE Act requires strong political commitment to manage the SOEs as commercial businesses. If this is done, and SOEs continue to seek opportunities to partner with the private sector and receive full compensation for CSOs, performance will improve.

E. MAURITIUS

SOEs are responsible for delivering services essential for Mauritius' competitiveness, and employ an estimated 36,000 workers. SOEs are active in almost every segment of the economy, providing power, water, transport, banking, agriculture, land development, and housing services. The five largest SOEs accounted for 72% of the assets and 98% of the portfolio's profit in 2014.[36] The largest SOE, Central Electricity Board, contributed 56% of the portfolio's profits in 2014.

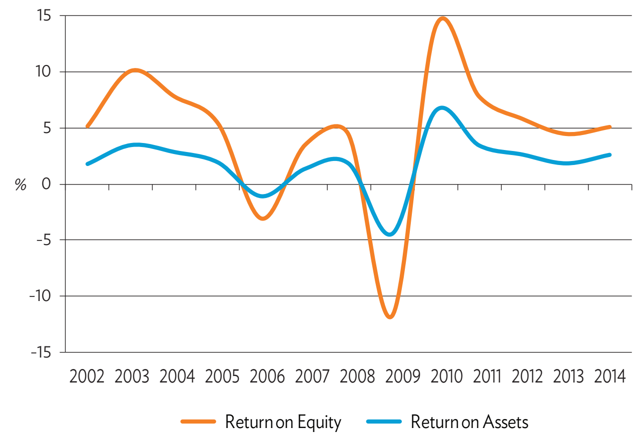
Eight of the SOEs are companies under the Companies Act while the remaining 12 are established by their own legislation. To be included in the SOE portfolio, the government must own and control at least 51% of the issued shares or, in the case of statutory bodies, have legal control. Many of the SOEs have mixed ownership, often with shares held by the government and other state owned entities.[37]

Figure 23: Mauritius State-Owned Enterprise Portfolio Assets, FY2014 (Rs118 billion)



FY = fiscal year, Rs = Mauritian rupee.
Source: Government of Mauritius, Office of Public Sector Governance.

Figure 24: Mauritius State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2002–FY2014



FY = fiscal year.
Source: Government of Mauritius, Office of Public Sector Governance.

The SOE portfolio generated an average ROA of 1.9% and ROE of 4.5% from 2002 to 2014. Profitability increased markedly from 2010 to 2014, with average portfolio ROA of 3% and ROE of 7.4%, compared with average ROA of 1.0% and ROE of 2.6% for the 2002–2009 period. The eight SOEs under the Companies Act generated 43% of the portfolio's total profit from 2002 to 2014 and had an average ROE of 5%, compared with the 12 SOEs established under their own legislation, which returned an average of (1%) on equity. Airports of Mauritius generated 26.3% of the total profits of the portfolio in 2002–2014, followed by the Mauritius Ports Authority at 27.3%, and the Central Electricity Board at 21%.

The combination of high gearing and the government's willingness to guarantee SOE debt is distorting the portfolio's true performance. Average portfolio gearing of 74% in 2010–2014[38] would not be sustainable without explicit government

[35] The SOE Act defines an "elected official" to include public servants, ministers and members of Parliament.

[36] In 2010, the IMF estimated that Investment expenditure for the 15 largest SOEs was 8.5% of GDP, and total government transfers to the SOE portfolio were estimated at 2.7% of GDP.

[37] Mauritius Telecom Limited has not been included in the portfolio as the government controls just 33.45% of the shareholding. Group France Telecom—Orange (40%), the State Bank of Mauritius through its wholly owned subsidiary SBM NFC Investments Limited (19%) and the National Pensions Fund (6.55%) own the bulk of the remaining shares. Air Mauritius Limited is included in the portfolio. Air Mauritius Holdings Limited owns 51% of the shares in Air Mauritius Limited, which is then owned by the government (43.83%) and the State Investment Corporation Limited (18.3%). The government owns 85% of the shares issued by the State Investment Corporation Limited.

[38] Total interest bearing debt divided by shareholders' funds.

support. In 2014, 89% of SOEs' total external debt of $384 million was guaranteed by the government. This support is not a recent trend, and probably explains why the average SOE borrowing cost in 2002–2014 was 13% below commercial lending rates. If the Mauritius SOEs had paid commercial rates for their debt, the average ROE in 2002–2014 would have been (5.7%). This represents a significant hidden subsidy and should cease. To reduce the government's exposure to unprofitable SOEs, it is merging some and restructuring others. Eleven SOEs have been identified as requiring immediate restructuring, and a further six have been merged into one. Seven SOEs were restructured in 2012 and 2013, and another four were undergoing reform in 2015. A major restructuring exercise, including an employee retrenchment plan, has commenced for the Mauritius Shipping Corporation and should be completed in 2016.

The SOEs operate under a comprehensive legislative framework. The Financial Reporting Act 2004 establishes the National Committee on Corporate Governance with the role to establish binding governance requirements for public and private companies and in particular SOEs. The Financial Reporting Act also establishes an Institute of Directors to "promote the highest standards of corporate governance, and of business and ethical conduct of directors serving on boards of companies and SOEs."[39] The Statutory Bodies (Accounts & Audit) Act 1972 stipulates that all noncompany SOEs must produce 3-year strategic plans. The plan must be included in their annual report and tabled in Parliament by the responsible minister.

Mauritius has taken important steps to strengthen the oversight of the SOE sector. In 2010, it created the Office of Public Sector Governance (OPSG) as a specialized monitoring and oversight unit, initially under the Prime Minister's Office. In 2015 the Office was transferred under the aegis of the new Ministry of Financial Services and Good Governance and Institutional Reforms. Implementation of improved governance and monitoring measures has started but remains difficult, as the OPSG has limited capacity.[40] Only 16% of SOEs prepared the required Corporate Objective Statement in 2015.

The fragmented structure of ownership monitoring remains a challenge. Sector ministries continue to be responsible for SOEs operating in their economic sector while the OPSG is responsible for monitoring SOE governance. As is the case in other countries participating in this benchmarking study, the involvement of sector ministers in the strategy and operations of SOEs in their sector undermines the commercial mandate of the SOEs. Sector ministries have policy and regulatory objectives which often conflict with maximizing the value of the state's investment in SOEs—the function of the shareholding or ownership ministry. Sector ministries should separate regulatory oversight from operations and achieve their policy objectives through regulation. Where necessary, CSOs should be purchased from SOEs or the private sector.

Box 7: State-Owned Enterprises Restructured in 2012–2013

- Business Parks of Mauritius
- Cyber Properties Investment
- National Transport Corporation
- Agricultural Marketing Board
- National Housing Development Company
- Small and Medium Enterprises Development Authority
- Mauritius Meat Authority

In addition to the governance reforms, the authorities are considering placing all commercial SOEs under the Companies Act. This has already been done for a number of SOEs requiring restructuring, as the Companies Act allows a much greater range of restructuring measures than the SOE's establishing legislation. PPPs are also being considered now that the PPP framework has been strengthened.[41] The transition to the Companies Act should facilitate the implementation of the Code of Corporate Governance, as there are no aspects of the code which conflict with the Companies Act.[42]

A Corporate Governance and Integrity Bill has been passed by Parliament and the final draft of the new Code of Corporate Governance is under consideration. The revised Code of Corporate Governance will require SOEs to prepare a corporate objective statement which has to include, among other matters, issues such as the vision, mission and values of the organization, value drivers, a statement of behavior of stakeholders, statement of accountability by the board, and expectations of financial as well as nonfinancial performance for the year. The revised code will also strengthen director selection and accountability. The draft code requires

39 Section 70, Financial Reporting Act 2004.

40 The Corporate Governance Unit of the OPSG comprises two staff members. They report that SOEs comply with 30%–67% of the code requirements.

41 These measures include the establishment of a PPP Unit, protocols for PPP project development between the PPP Unit and sponsoring line agencies, and technical training.

42 Conflicts between the Code of Corporate Governance and the establishing legislation of some SOEs have inhibited implementation of the code.

position descriptions for every board member and will encourage boards to undertake formal, rigorous, and regular performance assessments. The OPSG believes that improved accountability and governance—through timely completion of audited accounts that report performance against plan—and strengthened and more transparent director selection will support improved SOE performance.

Sustained reform will require placing SOEs on a firm commercial footing, supported by a clear framework for CSOs and accountability mechanisms that create real incentives for performance. This framework would allow the government to continue to use SOEs to deliver public services, but would ensure that these services are delivered in a more efficient, transparent, and sustainable manner. Full cost recovery would be required. This reform would be supported by converting all SOEs to companies under the Companies Act and strengthening the existing SOE legislative framework. The strengthened legal framework should require that all SOEs

- have a primary objective to operate profitably,
- receive full compensation for all CSOs,
- hold the board and management of SOEs accountable for results,
- prepare business plans, statements of corporate intent,[43] and report regularly to OPSG, and
- operate on a level playing field with private firms.

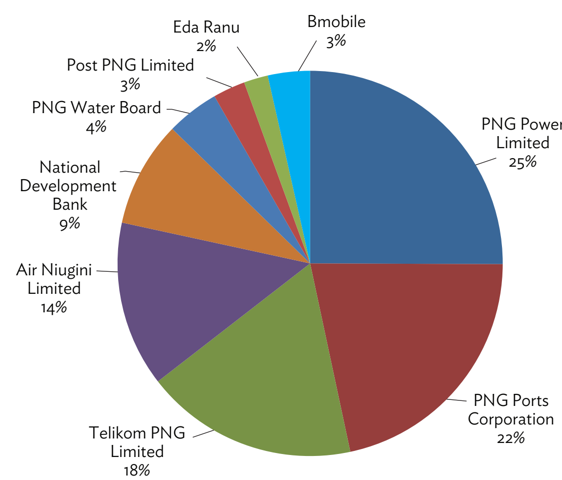
A strengthened OPSG is needed to support SOE reform. The establishment of a new Ministry of Financial Services and Good Governance and Institutional Reform is an important step in elevating the importance of SOE governance. The OPSG has a mandate to oversee the performance of the SOEs yet needs additional resources, authority, and skills to do this effectively. At the time of this study, the Corporate Governance Review Unit of the OPSG had only two staff. Centralizing SOE ownership monitoring within a strengthened and better resourced OPSG would improve OPSG's effectiveness, as would wide public dissemination of SOE results. This, combined with high-level support for OPSG's mandate, will allow it to play a critical role in improving the performance of the portfolio as a whole.

F. PAPUA NEW GUINEA

Papua New Guinea's SOE portfolio profitability has steadily declined since its peak in 2005. Over the 2002–2014 period, the portfolio's average ROA was 2.9% and ROE was 5%. Average performance has declined over the most recent 2010–2014 period, with ROA at 1.3% and ROE at 2.4%, compared with average ROA of 4% and ROE of 7% the preceding 2002–2009 period (Figure 26). The composition of PNG's portfolio has remained unchanged during the 2002–2013 period, with one SOE added in 2014.

Portfolio profitability in 2010–2014 was largely driven by the contributions of three SOEs: PNG Ports, PNG Power, and Air Niugini. These SOEs delivered a net profit of K510 million during the 2010–2014 period, while PNG Telikom accumulated net losses of K129 million. Regulatory contracts for PNG Ports and PNG Power have helped to ensure strong revenue growth but, in the view of the regulator, have not produced expected efficiency gains. The portfolio produced a consolidated loss in 2013, but recovered in 2014.[44]

Figure 25: Papua New Guinea State-Owned Enterprise Portfolio Assets, FY2014 (K6.5 billion)

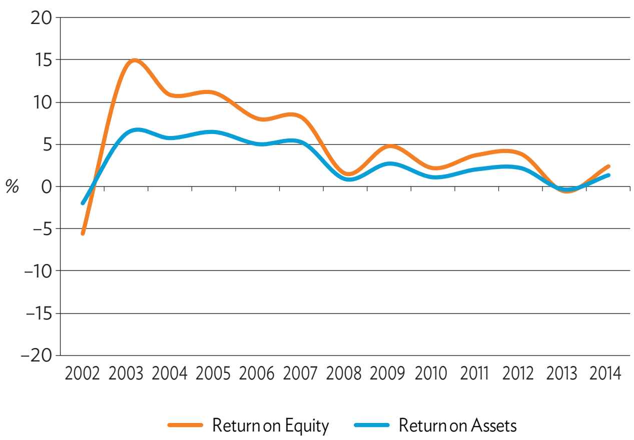


FY = fiscal year, K = kina, PNG = Papua New Guinea.
Source: Kumul Consolidated Holdings.

[43] SOEs are currently signing management contracts which may serve a similar purpose as statements of corporate intent. The Code of Corporate Governance for Mauritius—Guidance for State-Owned Enterprises recommends that SOEs produce a corporate objective statement. This is similar to a statement of corporate objectives, but less specific.

[44] PNG's Independent Consumer and Competition Commission regulates five SOEs as monopoly service providers; PNG Ports and PNG Power have regulatory contracts with price paths tied to agreed performance standards and investment plans; productivity incentives built into the regulatory contracts are not systematically taken up, reflecting the weaker performance incentives of SOEs versus private enterprises.

Figure 26: Papua New Guinea State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2002–FY2014



FY = fiscal year.
Source: Kumul Consolidated Holdings.

The assets controlled by PNG's SOEs have grown rapidly, but evidence suggests that asset use is inefficient. From 2003 to 2014, SOE assets grew at an average of 13.7% annually, well above the average of 8.2% among all of the benchmarked countries. Portfolio asset utilization declined from a high of 77% in 2005 to 46% in 2014.[45] The revaluation of existing assets accounted for 27% of portfolio growth from 2002 to 2014. The government supported the buildup of assets through K880 million of debt write-downs and equity injections and by allowing SOEs to reinvest the majority of their earnings rather than pay dividends. Dividend payments during the 2002–2014 period totaled K56 million.[46]

PNG's SOEs have paid close to commercial rates of interest on their debt, so their ROE is not inflated by subsidized credit. Historically cheap credit added as much as 4.7% to SOE equity returns, but from 2010 to 2014, this had fallen to less than 1.7% as the spread between SOE borrowing costs and commercial interest rates narrowed to an average of only 2.1%. The Department of Treasury has developed a policy to govern onlending practices to ensure SOEs borrow at market rates. This will maintain the pressure on SOEs to invest efficiently and support competitive neutrality between SOEs and private companies that compete now or may compete in the future.

In 2015, the government endorsed a new Policy on State Ownership and Participation in Commercial Activities, and gave the National Executive Council (NEC) direct governance responsibilities over the SOE portfolio. The SOE Policy and restructuring of the SOE portfolio under Kumul Consolidated Holdings (Box 8) are intended to improve the performance of the SOEs, but incorporate a number of measures which are at odds with international best practice. The policy calls for an expansion of state investment in commercial activities,[47] citing the PNG Constitution,[48] and prohibits foreign investors from taking controlling interests in SOEs or PPPs. Specifically, the policy calls for the state to (i) reduce its investment in SOEs to 51%, selling off 34% to domestic investors and 15% to foreign investors; (ii) introduce legislation requiring foreign investors to allocate at least 51% in any investment to private or public corporations owned by PNG citizens; and (iii) prohibit allocation of land titles, whether state leases, customary leases, or freehold titles to noncitizens and foreign-owned corporations.

The policy appears to be in direct conflict with statements made by the Prime Minister and the 2012–2016 budget speeches, which recognize the poor performance of the SOEs and the importance of the private sector in driving economic growth. It also appears to contradict the minister of public enterprises' own statements regarding the restructuring of the power sector and need to attract private investment in generation and transmission. Limiting foreign investment in infrastructure to minority stakes is inconsistent with the 2011 Electricity Industry Policy and spirit of the 2014 Public–Private Partnership Act, which calls for increased private (foreign and domestic) investments in the provision of infrastructure services. While the policy does not have the force of law, it does send a mixed signal to investors regarding the government's attitude towards foreign investment and continued competition from SOEs in commercial activities.

The government piloted the new Community Service Obligation Policy for SOEs in 2015, establishing a process and technical parameters which can be applied to other SOEs in 2016. The pilot focused on only one SOE, but the majority of SOEs provide CSOs, mostly funded through

45 Asset utilization measures the amount of revenue generated by each kina of assets in the portfolio; a ratio of 46% means that each kina of asset value in the portfolio produced K0.46 of revenue.

46 This does not include the K415 million dividend paid by Kumul Petroleum in 2014 as this entity was not an SOE owned and controlled by IPBC.

47 Page xix of the Policy on State Ownership and Participation in Commercial Activities recommends that "The State should diversify into other sectors it had not traditionally participated in as an investor, such as agriculture, manufacturing, banking and finance, service industry, forestry, fisheries and eco-tourism." By the fourth quarter of 2015, Kumul Consolidated Holdings had already been directed to explore investments in these new sectors.

48 Page xvii of the Policy on State Ownership and Participation in Commercial Activities states that there is a "Constitutional Directive for the government to enable 'citizens and governmental bodies to have control of bulk of the economic enterprises and production.' To that end, the State is mandated 'to take effective measures to control and actively participate in the national economy, and in particular to control major enterprises engaged in the exploitation of natural resources.'"

Box 8: Kumul Consolidated Holdings

In 2015, the Independent Public Business Corporation (IPBC) was amended to create Kumul Consolidated Holdings (KCH).[a] This is part of the Government of Papua New Guinea's broader restructuring of state investments that created Kumul Petroleum Holdings and Kumul Mineral Holdings for investments in the extractive industries. KCH assumes control over the General Business Trust in which the assets of the state-owned enterprise (SOE) portfolio are held, taking over this role from IPBC.

The government's stated purpose for the restructure is to give the SOEs greater autonomy and accountability for results. The act transfers all of the oversight responsibilities over KCH and the SOEs to the National Executive Council (NEC), giving it authority to appoint SOE directors and approve corporate plans. KCH is largely reduced to administering the state's ownership in the SOEs, but with no effective control.

The act gives the minister of SOEs broad powers, subject to NEC endorsement, to direct an SOE concerning its operations, remuneration levels, tenders, engagement of consultants, and other matters. The act does not strengthen the commercial mandate of the SOEs, stating only that their annual plans must demonstrate that they will maintain an excess of assets over liabilities and will be able to meet their debts when they fall due.

The net effect of the act is to give NEC direct governance control over the SOEs. This will substantially increase the workload of the NEC as it assumes responsibilities normally reserved for SOE boards. It is an unusual practice internationally, and increases the risk of political considerations overriding commercial targets, as elected members of NEC exert their authority over the operation of the SOEs.[b]

[a] Independent Public Business Corporation of Papua New Guinea (Kumul Consolidated Holdings) (Amendment) Act 2015.

[b] Page 34 of the SOE Policy states "Politicization in the direct appointment of SOE board directors by the National Executive Council (NEC) without proper due diligence and screening of candidates has been the root cause of bad and incompetent corporate governance leading to corruption, mismanagement, and loss of focus."

cross-subsidies.[49] This practice provides weak incentives for service provision in high-cost areas, prevents more efficient providers from entering the market, and undermines SOEs' focus on commercial performance. The CSO policy calls for commercial contracts to be used for the delivery of CSOs, increasing transparency and accountability and improving outcomes for SOEs, consumers, and the government. To

[49] The exception is Air Niugini, which receives a direct cash payment from the government for running a loss-making route to Japan.

Box 9: Implementing the Papua New Guinea Public–Private Partnerships Act 2014

The 2014 Public–Private Partnerships (PPP) Act of Papua New Guinea requires government agencies to consider using PPP structures to develop all large new infrastructure investments. Mirroring successful PPP programs globally, these agencies will work with a small PPP center to develop potential PPP projects through a robust and predictable process. This will help the government to build up expertise in PPP project development, enhance PPP fiscal risk management, and increase credibility in the PPP program.

Implementation of the PPP Act should accelerate the conclusion of PPP transactions, as there will be clear lines of responsibility for project development. It is likely that, had this process been in place in 2013 when the Lae Port PPP transaction was initiated, an operator could have been appointed by 2015. The absence of a clear process and responsibilities for PPP project development has been a major reason for project delays in a number of sectors. Implementation of the PPP Act as endorsed by Parliament in 2014 will directly address this.

ensure that the government maximizes value for money when it purchases CSOs, they should be competitively tendered wherever feasible. The piloting of the CSO process did not result in a budget allocation for 2016, but has added much more transparency around the cost of CSOs and their impact on the profitability of the SOE. This process should, therefore, be extended to other SOEs in 2016.

Parliament passed the Public–Private Partnerships Act in September 2014, encouraging greater use of PPPs to help improve SOE efficiency and public finances. When fully implemented, the PPP Act will allow the state to leverage private sector finance, technology, and management expertise to expand infrastructure services throughout the country (Box 9). Instead of relying solely on public finance, SOEs, and government departments, PPP structures will allow the government to transfer service delivery risk to private partners and, crucially, to build strong maintenance incentives to extend the life of infrastructure assets. In the absence of this framework, major infrastructure projects (e.g., Lae Port Tidal Basin, Jackson's Airport upgrade, South Pacific Games facilities) have been funded directly through public borrowing rather than through the shared financing opportunities provided by PPP structures. This has placed an additional strain on the national budget, as recognized in the 2016 Budget speech. In the first quarter of 2016, Treasury signaled its intention to amend the PPP Act rather than gazette it as endorsed by the Parliament.

This process will further delay the establishment of a robust and transparent PPP project development process.

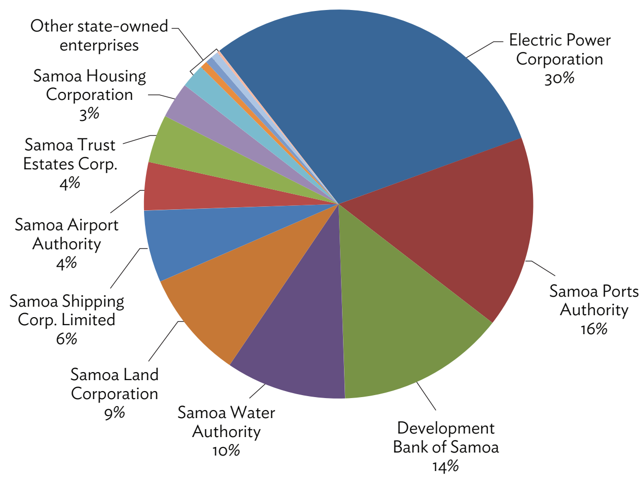
Improving the performance of the SOEs must include greater transparency and accountability. Most SOEs have failed to produce financial accounts in a timely manner. The requirement that SOE accounts be certified by the auditor general has contributed to the backlog. Once certified, accounts should become publicly available. Audited financial statements for Independent Public Business Corporation (IPBC) and the Government Business Trust are not publicly available. Recent pledges by the Ministry of Public Enterprises to improve transparency should strengthen the performance incentives for the SOEs. Summaries of corporate plans detailing financial and operational targets, CSOs, and other important goals should be made public so that annual assessments can be made. Partial listings on the Port Moresby stock exchange, as is being contemplated for some SOEs, would further support the government's pledge towards increased transparency.

As international experience has amply demonstrated, greater competition from and collaboration with the private sector will be the most powerful mechanism to enhance SOE performance. The privatization of the PNG Banking Corporation is a compelling case in point. Having sold its majority stake to Bank of South Pacific, which is exposed to vigorous competition, it is now one of the most successful banks in the country. The government's plans to partially privatize Air Niugini, and expand the use of PPPs in the power and port sectors should enhance the productivity of these SOEs. SOEs still hold monopoly positions in a number of sectors, however, inhibiting private investment and innovation. The introduction of the CSO contracting framework provides a mechanism to end the cross-subsidization that entrenches sector monopolies in the ports, airports, water, and power sectors. The current restructuring of the power sector to allow greater private participation and investment should provide an important precedent for other sectors, which should be similarly examined. The strengthening of PNG's legal, regulatory, and institutional framework for competition—which is currently underway—will support increased competition in sectors heretofore reserved for SOEs. Ultimately, the government's responsibility is to facilitate the efficient provision of services to the people, not to reserve or protect markets for SOEs.

G. SAMOA

Samoa's SOE portfolio comprises 15 entities engaged in a diverse range of activities including transport, utilities, subsidized housing, postal services, banking, land development, and trustee services. The portfolio is sizeable, with ST1.37 billion in total assets, yet contributing just 3% to GDP in 2014.

Figure 27: Samoa State-Owned Enterprise Portfolio Assets, FY2014 (ST1.4 billion)



FY = fiscal year, ST = tala.

Source: Government of Samoa, State-Owned Enterprise Monitoring Unit, Ministry of Finance.

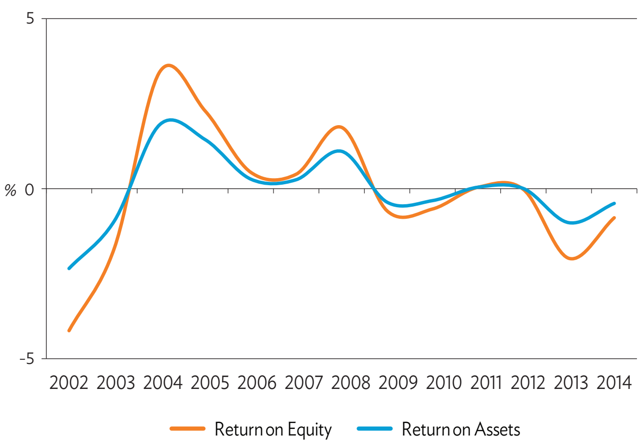
Despite possessing a comprehensive SOE Act,[50] and an overarching reform and divestment policy calling for the divestment of all nonstrategic SOEs,[51] there has been no improvement in SOE performance since 2003. Implementation of the SOE policy and SOE Act has been weak. Average ROE for 2002–2014 was (0.1%) and average for ROA was (0.0%). The average has not climbed above 0% since 2008. Portfolio performance in 2010-2014 confirms a downward trend with average ROE dropping to (0.6%) and average ROA to (0.3%). Samoa is one of only two countries in the benchmarking sample to show no material improvement in portfolio ROE for 2002–2014, despite access to subsidized credit—reaching 7.3% below the commercial rate on average—and cumulative government transfers of $112 million since 2003.

Average government transfers to SOEs during 2010–2014 were equivalent to 0.9% of GDP. This contrasts sharply with Tonga, where the SOEs made an $18.7 million net contribution to the government over the same period. The social and

50 The Public Bodies (Performance and Accountabilities) Act was adopted in 2001.

51 The SOEs considered strategic include the Electric Power Corporation, Samoa Airport Authority, Samoa Ports Authority, Samoa Shipping Corporation, and Samoa Water Authority.

Figure 28: Samoa State-Owned Enterprise Return on Equity and Return on Assets, FY2002–FY2014



FY = fiscal year.
Source: Government of Samoa, State-Owned Enterprise Monitoring Unit, Ministry of Finance.

economic costs of subsidizing underperforming SOEs is significant—government transfers in the 2010–2014 period equate to 24.9% of total government spending on health. This figure does not include the ST63.4 million of subsidized loans to SOEs and government-controlled commercial entities provided by the Unit Trust of Samoa (UTOS) in 2014. Since 2010, UTOS, which is managed by a SOE, has provided subsidized loans, propping up underperforming SOEs and crowding out private sector financial institutions.[52]

The five largest SOEs represented 79% of total portfolio assets in 2014, but only one generated a positive average ROE for 2002–2014: Electric Power Corporation, whose average ROE was just 1% over that period. It is not clear why the government continues to support loss-making and insolvent[53] SOEs through soft loans from the government or investments by state-owned financial institutions, such as Samoa National Provident Fund, Development Bank of Samoa, the Accident Compensation Corporation, or the UTOS. Despite removing politicians from SOE boards in 2010, the government has continued to allow inappropriate levels of ministerial influence over SOE boards, thereby undermining the SOE's commercial mandate.

Reform momentum has slowly increased since 2008. Samoa Broadcasting Corporation was privatized in 2008, followed by Samoatel in 2010. That year also saw the establishment of an independent SOE director selection panel and, in 2012, the passage of the Composition Act resulting in the removal of all ministers from SOE boards and the appointment of 180 new directors. While the SOE Act prohibits nondirectors from influencing board decisions, ministers, and cabinet continued to have significant operational control over the SOEs after the 2012 reform. In January 2015, the cabinet approved a new SOE Ownership, Performance and Divestment Policy, acknowledging that governments are not good owners of commercial assets. The approved policy reaffirmed that all commercial SOEs, apart from SOEs that lacked effective competition or regulation, should be privatized. The cabinet directed that three SOEs should be sold by December 2015;[54] progress on these transactions has been slow.

The existence of line or sector ministers serving as the responsible minister for SOEs in their sectors frustrated reform efforts. This created an irreconcilable conflict of interest as the line minister saw the SOE as an instrument to achieve policy outcomes, rather than an operationally independent commercial enterprise. Recognizing that the current model was not delivering the desired results—improved SOE performance—in 2014, the government appointed a SOE minister to be responsible for all SOEs. This appointment was confirmed in a 2015 amendment to the 2001 SOE Act, making the SOE minister the sole responsible minister, and joint shareholding minister with the minister of finance. The amending SOE Act established an SOE Ministry[55] to support the new minister. The SOE Ministry was formally established in July 2015.

The appointment of an SOE minister, supported by a specialist ministry, creates a robust framework for SOE ownership monitoring. It is consistent with international trends and international good practice. How successful it will be in lifting the performance of Samoa's SOEs, from a 0% average ROE to the government's 7% target, will be determined by how effectively it is implemented. It will also be determined by the pace of continued SOE restructuring, privatization, partnerships with the private sector, and compliance with the new competition framework.

[52] UTOS was formed in 2010 by the government and is managed by UTOS (Management) Limited, a SOE. Total loans to SOEs and government-controlled entities were ST52.2 million in 2013, representing 88% of total liquid financial assets; and ST63.4 million in 2014, representing 89% of total liquid financial assets. Loans to SOEs are guaranteed by the government.

[53] The government had to inject ST63 million to support Samoa Port Authority and Agricultural Stores Corporation in 2012. The Public Trust Office and the Samoan Shipping Services are either technically insolvent or have negative shareholders' equity.

[54] Samoa Housing Corporation, Public Trust Office, and Samoa Post Limited.

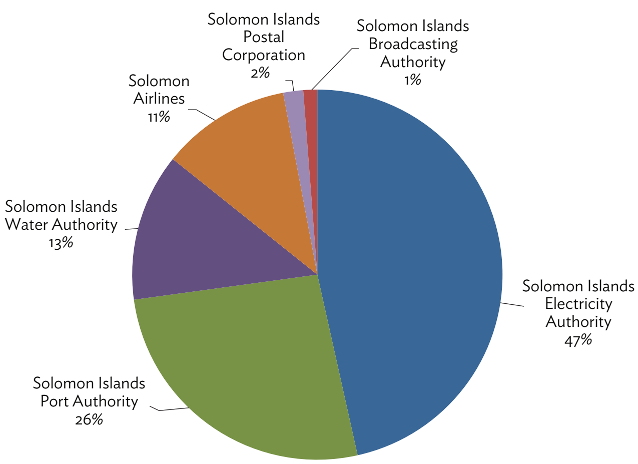
[55] The SOE Monitoring Division within the Ministry of Finance previously performed the SOE ownership-monitoring role.

The adoption of a competition policy in 2013 and enactment of the Competition and Consumer Act in 2016 should have a profound impact on SOEs. The framework requires ministers to consider the competitive impact of their decisions relating to the provision of goods and services by SOEs. It will encourage the competitive tendering of government contracts for CSOs, restrict subsidies to SOEs that lessen competition, and deter anticompetitive collusion and abuse of market power. It will be fully supportive of the commercialization objective of the SOE Act and subsequent reforms adopted since 2008, and should, therefore, have a positive impact on SOE performance.

H. SOLOMON ISLANDS

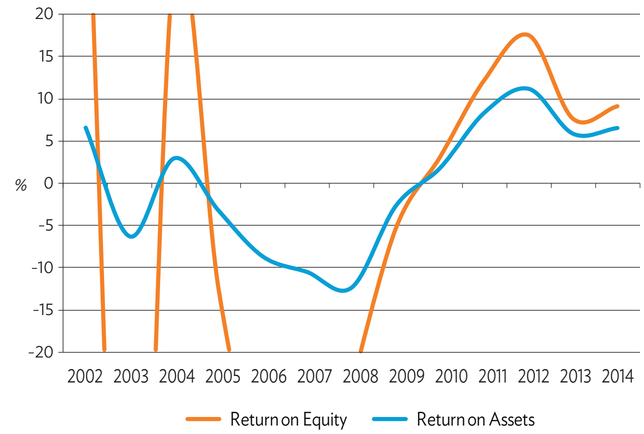
The Solomon Islands SOE portfolio has undergone a dramatic turnaround since 2009. It is now the most profitable portfolio in the Pacific, and in this benchmarking sample. Average ROE of the portfolio increased from (11%) in 2002–2009, to 10% in 2010–2014, and 9% in 2014. The turnaround can be attributed to (i) financial restructuring of three of the largest SOEs[56]; (ii) tariff increases at Solomon Islands Water Authority (SIWA) and Solomon Islands Port Authority (SIPA), and improved collections for Solomon Islands Electricity Authority (SIEA)[57] and SIWA; (iii) privatization and liquidation of nonstrategic SOEs; and (iv) improved implementation of the SOE Act, in particular the CSO provisions.

Figure 29: Solomon Islands State-Owned Enterprise Portfolio Assets, FY2014 (SI$1.6 billion)



FY = fiscal year, SI$ = Solomon Islands dollar.
Source: Government of Solomon Islands, Ministry of Finance and Treasury.

Figure 30: Solomon Islands State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2002–FY2014



FY = fiscal year.
Source: Government of Solomon Islands, Ministry of Finance and Treasury.

The portfolio is relatively small, with only six active SOEs,[58] the largest of which (SIEA) represented 47% of the assets and 83% of the profit in 2014. Without SIEA, portfolio ROE would have been only 2% in 2014. SIEA has contributed an average of 70% of the portfolio's net profits since 2010. Its performance has substantially improved since 2009 due to its ability to charge a commercial tariff, receive compensation for CSOs, and improve metering and collections. SIWA, the water utility, has also undergone a dramatic turnaround since 2011, more than tripling its revenue through improved collections, tariff increases, and reductions in nonrevenue water, while only increasing its costs by 180%. SIWA has gone from a negative shareholder equity position in 2011 to a 15% ROE in 2014. The sharp decline in the portfolio's profitability in 2013 was due to SIPA, whose net earnings fell from SI$39 million in 2012, to SI$1 million in 2013. Solomon Airlines (SAL) continues to struggle since 2011, booking total losses of SI$22 million from 2012 to 2014.

The two smallest SOEs need substantial restructuring. Core operations income of SIBC and Solomon Islands Postal Corporation (SIPC) continue to decline, outpacing decreases in operating costs. While CSO payments have helped to reduce losses, a wholesale review and restructuring of both businesses is necessary to ensure sustainability. Selected activities could

[56] SIEA, SIWA, and SAL.

[57] Now trading as Solomon Power.

[58] Two SOEs are listed under the SOE Act 2007, but not included in this study: Commodities Export Marketing Authority (CEMA) and Investment Corporation of the Solomon Islands (ICSI); CEMA is principally a regulatory agency without commercial activities; and ICSI is an SOE holding company.

be discontinued, contracted out, or sold to the private sector to attract new investment and expertise for both businesses.

The port authority (SIPA), a vital link for the private sector, suffers from low productivity. Asset utilization has dropped from an average of 77% in 2010–2012 to 26% in 2013–2014. From 2012 to 2014, total expenses jumped 57% while revenues increased by only 8%. SIPA is one of the few ports in the region not structured as a landlord operator, instead running most port activities in an integrated manner. This means that it foregoes the efficiency incentives that come from placing stevedoring and other port services under competitively tendered contracts. It also crowds out the private sector.

In 2015, SIPA began diversifying its activities into areas currently run by private businesses, such as noodle and rice importation. In the absence of competition or SOE policies in Solomon Islands, these activities remain unregulated, with potential negative impact on the private sector. Sharp increases in port-related fees, making the Honiara port one of the most expensive in the region, have raised concern in the business community and led to price hikes for imports and exports. In 2015, SIPA engaged a new chief executive officer and embarked on a reform program whose details are not publicly available at the time of publication, but which does not appear to include the restructuring of the business to encourage more competition for services. Failure to produce a statement of corporate objectives places SIPA in breach of the SOE Act. Improved performance at SIPA could be achieved by restructuring and focusing on the port business and full compliance with the SOE Act.

Since 2008, the government has successfully divested both profitable and unprofitable SOEs. Four SOEs were divested using different mechanisms, a PPP (Sasape Marina), a merger with the National Provident Fund, a sale of shares to existing private shareholders (Soltai), and a liquidation of assets (SolPrint). All four transactions resulted in a reduced fiscal burden on the government, and two have catalyzed new investment from the private sector, and an expansion of service opportunities. This experience demonstrates that privatization can be successful even for loss-making SOEs.

Most SOEs are undercapitalized and need partnerships with the private sector to survive. Many SOEs are looking to make substantial capital investments over the next 5 years. SIWA and SAL are particularly vulnerable, with shareholder equity financing only 20% and 23% of assets in 2014, respectively. The Ministry of Finance has recognized the potential for PPPs, outsourcing, and privatization to address SOE capitalization requirements, but has yet to prepare a new policy to guide reform. This policy is urgently needed.

The government has announced plans to invest in and revitalize SOEs that should be wound up: Development Bank of the Solomon Islands, CEMA, and Investment Corporation of the Solomon Islands (ICSI). The rationale for these investments has not been publicly elaborated. Development Bank of the Solomon Islands has been in liquidation since 2005, when it became insolvent. CEMA is essentially a regulatory body, so would appear most suited to reintegration into the Ministry of Agriculture. ICSI is a holding company for SOE shares and other government assets. Given the existence of an SOE monitoring unit within the Ministry of Finance, ICSI plays no monitoring or governance role over the SOEs. It is a shell that carries the costs of running a full board and executive staff. A clear policy on the role of SOEs and state investments in commercial activities would provide much-needed guidance for these decisions.

The portfolio's strong recovery remains fragile, and depends on the government's continued implementation of the SOE Act. The SOE Act and its supporting regulations[59] establish a robust framework for commercially managing SOEs. It requires the SOEs to operate profitably, imposes a rigorous director selection and appointment process, defines corporate planning and reporting requirements, and establishes a process for the transparent identification, costing, and financing of CSOs. Adherence to the SOE Act appears to be weakening since 2014, in particular in the director selection and appointment process, and in the implementation of the CSO provisions. Consolidation of the SOE ownership monitoring function into a single minister could facilitate the implementation of the SOE Act with those SOEs currently under the oversight of both the minister of finance and their sector minister. This is the case for SIEA, SIPA, SIPC, SIBC, SIWA, and CEMA.[60]

Corporate planning and reporting remain weak. With the exception of the largest SOEs, others struggle to prepare meaningful statements of corporate objectives (SCO) and corporate plans, and submit their audited annual accounts within 3 months of a financial year.[61] In 2013 and 2014, all SOEs prepared SCOs, but most did not prepare business plans and only SIEA completed their audited annual accounts within the required time. SCOs are not reflecting the impact of CSOs on

[59] The State-Owned Enterprise Act 2007 and the State-Owned Enterprise Regulations 2010.

[60] SAL and ICSI are already under the sole oversight of the minister of finance.

[61] Section 14 of the State-Owned Enterprise Act 2007.

Box 10: Community Service Obligations: Can Solomon Islands Maintain the Standard It Has Set for the Pacific?

Solomon Islands has one of the most robust community service obligation (CSO) contracting frameworks in the Pacific, with CSO contracts signed each year since 2011. These performance-based contracts trigger payments after services are delivered, allow SOEs to meet their profitability targets, and allow the government to assess the cost of the CSOs and make choices based on the benefits generated. While the government has not yet sought to contract out CSOs to the private sector, it now has the ability to do so and should pursue this option wherever it can provide further cost savings.

To finance CSOs, SI$39 million was approved in 2014 and SI$29 million in 2015.[a] In 2015, the new government only agreed to sign CSO contracts with the smaller state-owned enterprises (SOEs), for a total of SI$5 million, however, rejecting the CSO proposals put forward by the larger SOEs for the balance of SI$24 million. The arbitrary nature of these decisions have compromised the ability of SOEs to deliver the services and undermined the integrity of the process.

While the SOE Act allows for SOEs to finance their CSOs through cross-subsidization, this must be agreed and documented in both the CSO contract and SCO. In the absence of this documentation, SOE directors which consent to the delivery of CSOs without receiving a written directive from the government would be in breach of their fiduciary obligations under the SOE Act.

In 2016, the Ministry of Finance did sign new CSO contracts with 6 SOEs, based on their 2015 cost estimates. While the return to formal contracting is a very positive development, it will be important that these are based on updated costing information every year, so that the Ministry of Finance can build in efficiency incentives for the SOEs.

[a] Five CSO contracts were signed in 2014 and six prepared in 2015, with three being signed; the 2015 budget estimates are lower than 2014 due primarily to a reduction in the Solomon Islands Electricity Authority payment (improved efficiency and lower fuel costs).

their projected profitability. The SOE monitoring unit[62] within the Ministry of Finance provides oversight and reports on SOE performance to the minister of finance, but lacks authority to enforce adherence to the SOE Act.

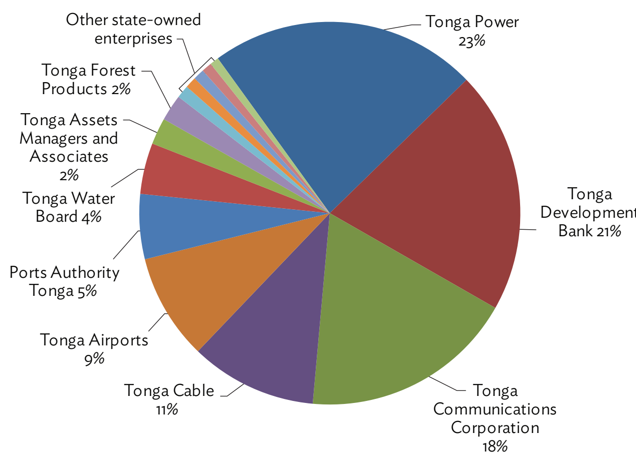
Sustaining the hard-earned gains from the reforms undertaken in 2010–2014 will require strong political will and increased stakeholder involvement. When political resolve to enforce the SOE Act weakens, civil society, the public, and other stakeholders can pressure politicians to comply with the law. This requires effective information dissemination, including the laws' broad provisions, the directors' roles and responsibilities, how elected officials can properly direct an SOE's affairs, and the consequences of poor SOE performance. In Solomon Islands, this could be achieved by publishing SOE accounts (as the SOE Act requires), public information campaigns explaining the SOE roles, and training for SOE directors.

The new government has an opportunity to express its commitment to efficient public service delivery and private sector development with the formulation and adoption of a new SOE policy. This policy would guide future investment in SOEs, including through partnerships with the private sector. It would send a signal to all stakeholders that the government is committed to improving access and affordability of public services in the most fiscally prudent manner.

I. TONGA

Tonga has 14 active SOEs involved in a range of commercial activities including utilities, transport, banking, and communication. In 2014, these SOEs represented 19%–23% of the country's total capital stock and contributed 7% to GDP. While this contribution is low relative to the size of the SOE sector, it compares favorably with the rest of the benchmarking sample, and was higher than Singapore's 4% and New Zealand's 1%. Tonga was one of the few countries where SOE profits

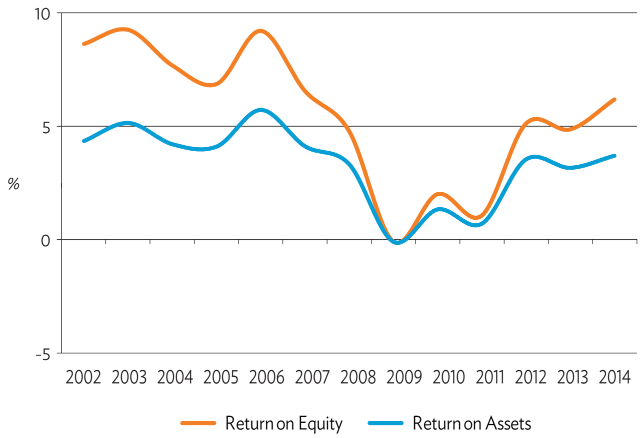
Figure 31: Tonga State Owned Enterprise Portfolio Assets, FY2014 (T$412 million)



FY = fiscal year, T$ = pa'anga.
Source: Government of Tonga, Ministry of Public Enterprises.

[62] The Economic Reform Unit.

Figure 32: Tonga State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2002–FY2014



FY = fiscal year.
Source: Government of Tonga, Ministry of Public Enterprises.

exceeded government transfers over the 2010–2014 period, with the SOE portfolio yielding a net surplus of $19 million (an average of 0.9% of GDP).

The portfolio's average returns were lower in the 2010–2014 period than in the preceding 2002–2009 period. Average ROE was 6.4% and average ROA was 3.8% during the 2002–2009 period, and dropped to 3.9% and 2.6% respectively in 2010–2014. The 2008 global financial crisis (GFC) had a significant adverse impact on Tonga's economy. The dramatic decline in Tonga Communications Corporation's financial performance, which generated 67% of the portfolio's total profits in 2002–2009, but returned 0% in 2009 and 2010 and generated a loss in 2011, has been a major factor.

Portfolio returns have been steadily improving since 2009, but have not yet reached pre-GFC levels. From a low of 0% in 2009, portfolio ROE increased to 6% and ROA to 3.7% in 2014. This has been driven by a general increase in profitability among all of the larger SOEs: Tonga Airports, Tonga Water Board, Ports Authority Tonga, Tonga Development Bank, Tonga Communications Corporation, and in particular Tonga Power—the latter contributed 52% of the portfolio profits in 2014. These six SOEs comprise 87% of total portfolio assets. The improvement in profitability has been supported by the progressive implementation of the government's reform initiatives. Tonga is one of the few countries in the study where the SOEs have made a net positive contribution to the government, totaling $25 million in the period 2003–2014.

A broad-based SOE reform program that commenced in 2006 continues to be implemented. An SOE Act was adopted in 2007 and SOE ownership monitoring was moved from the Ministry of Finance to a newly established Ministry of Public Enterprises (MPE), with the minister of public enterprises the sole responsible minister. Since that time, a significant number of reform initiatives have been undertaken including privatizing two SOEs; developing restructuring plans for 10 SOEs; amending the SOE Act; and enhancing SOE governance, reporting, accountability, and ownership monitoring (Box 11).

Tonga has one of the strongest performance monitoring frameworks in the benchmarking sample. The most basic monitoring tool is the audited annual accounts. Without current audited accounts, it is impossible to hold boards accountable and boards are unable to exercise their most basic governance duties. Almost 90% of Tonga's SOEs submitted 2014 accounts within 6 months from the end of the financial year, as required by their SOE Act. Tonga remains the only Pacific island country that publishes summaries of SOE audited annual accounts in local newspapers reporting performance against targets set in the business plan. The Ministry of Public Enterprises has also implemented a standardized reporting format for all SOEs and developed SOE specific profit targets, based on a simplified capital asset pricing model.

Box 11: Tonga Reform Highlights 2007–2014

Privatizations: Leiola Duty Free; Tonga Machinery Pool

Liquidations: Shipping Corporation of Polynesia; Tonga Investments (including sale of Home Gas); Tonga Print

Contracting out: Tonga Water Board

Legislation: Amended SOE Act (2010)

State-owned enterprise monitoring: Development of letters of expectation to guide business plan development, monitoring framework, training and development, state-owned enterprise (SOE)-specific profit targets, semiannual reporting against plan targets, approved SOE divestment, ownership, and reform policy

Governance: Ministers removed from boards, appointment of public servants to SOE boards restricted, skills-based selection process for SOE directors, director performance reviews and advertising for new directors, shared boards

Accountability and reporting: Summary of SOE performance published in local newspapers, audited accounts generally submitted on time, directors removed for poor performance, CSO policy fully implemented

To overcome shortages of qualified and appropriately skilled directors, in 2015 the Ministry of Public Enterprises introduced the concept of shared SOE boards. SOEs with similar attributes were grouped, the utilities group (comprising Tonga Power Limited, Tonga Water Board, and Waste Authority Limited), and the information, communication, and telecommunication (information and communication technology) group (comprising Tonga Communications Corporation, Tonga Post and Printing Limited, and Tonga Broadcasting Commission). Shared boards are also intended to encourage the development of shared services, such as accounting, billing, customer service interface, and, where possible, operations. This should both reduce costs and improve efficiencies.

While limited progress has been made in privatizing SOEs since 2013, the adoption of a new SOE Ownership, Divestment and Reform Policy in 2014 has established a new divestment pipeline. The policy identifies seven SOEs that should be targeted for privatization, and sets out high-level reform strategies for each SOE. Tonga Communications Corporation, Tonga Forest Products Limited, and Tonga Export Quality Management Limited are identified as the highest priorities for divestment. The government is currently evaluating sales options for all three.

As evidenced by the financial performance of the SOE portfolio since 2002, maintaining commercial returns requires a strong emphasis on governance, monitoring, and continued divestment of assets that can be more efficiently operated by the private sector. Maintaining reform gains is challenging. In October 2012, the cabinet considered amending the SOE Act to reinstate their power to appoint elected officials as SOE directors; pressure has been placed on SOEs, most notably Tonga Power, to provide services below their true cost;[63] and Tonga Ports Authority was directed by the government to lend T$0.5 million to Waste Authority Limited to keep that SOE liquid.[64]

The outsourcing of selected services by the Tonga Water Board in 2015 is a small step towards more private sector participation in the delivery of infrastructure services. Other opportunities exist in the power, waste, and transport sectors, including through the contracting out of CSOs. These opportunities should be pursued as an integral part of the implementation of the new SOE Policy.

63 Prime Minister's directive issued to Tonga Power in March 2013.

64 Loan was advanced in 2011. Source: Tonga Ports Authority. 2014. *2014 Annual Report*. Nuku'alofa.

J. VANUATU

The Vanuatu SOE portfolio comprises seven active SOEs involved in banking, broadcasting, postal operations, and transport. It has one of the smallest SOE portfolios relative to the size of its economy in this benchmarking sample, largely due to the absence of large utility SOEs: the portfolio represents 7%–8% of total capital stock in the economy, and contributed 2% to GDP in 2014.[65] The average ROA for the period 2010–2013 was 1%: the average ROE for the same period was 4% a significant improvement over 2008–2009 when average ROA was (4%) and average ROE was (17%). Only three of the eight SOEs generated an aggregate positive return from 2008–2014 (National Bank of Vanuatu, Vanuatu Post,[66] and Airports Vanuatu). The largest SOE, National Bank of Vanuatu,[67] was the most profitable in 2010–2014, achieving an average ROE of 10.5%. Profitability is declining, from an ROE of 17% in 2010 to 5% in 2014, caused in part by informal and unfunded CSOs, estimated at $1.7 million in 2014.[68] The portfolio has absorbed a total of $23 million in government transfers from 2010 to 2014, and required ongoing government guarantees and advances to support SOE operations, totalling $36.4 million in 2013.[69] Government guarantees and subsidised loans have reduced SOEs' cost of borrowing below commercial rates—as is the case with most other benchmarked countries. Vanuatu's average cost of SOE borrowing in 2010–2014 was 3.8%, 6.3% below average commercial borrowing rates for the same period.

The three largest SOEs—National Bank of Vanuatu, Air Vanuatu (Operations) Limited (AVOL), and Airports Vanuatu Limited (AVL)—comprise 96% of total SOE assets. Air Vanuatu alone contributed 94% of the portfolio's total losses from 2008 to 2014, and reported negative shareholders' funds in every year except FY2013, when debt owed to the government was converted to equity. The company's financial performance has been adversely impacted by unfunded CSOs, estimated at Vt176 million in 2013[70] alone, resulting in a Vt1.3 billion loan and Vt2.0 billion guarantee from the government to keep the SOE flying. These unfunded CSOs are

65 Not all of the eight SOEs included in the study produced audited accounts for the period 2008–2014. Vanuatu Post Limited, for example, has not produced audited accounts for 2014, and accounts for 2013 are unaudited. Vanuatu Post Limited represented approximately 8% of portfolio assets in 2013.

66 Vanuatu Post's aggregate positive return from 2008–2013.

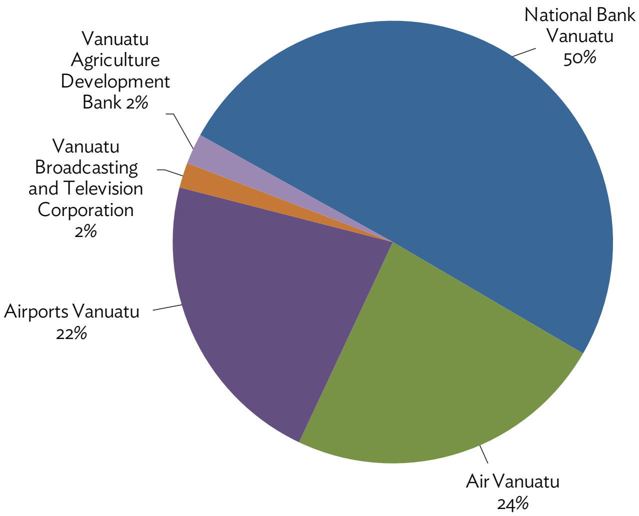
67 The Government of Vanuatu owns 70% of the issued share capital. The International Finance Corporation and the Vanuatu National Provident Fund acquired 15% each of issued share capital in November 2012.

68 CSO relates to the cost of sustaining the NBV's rural outreach program and is based on management estimate of raw cost.

69 Government guarantees $23.4 million; government advances $13.0 million as disclosed in December 2013 government financial statements—the most recent available.

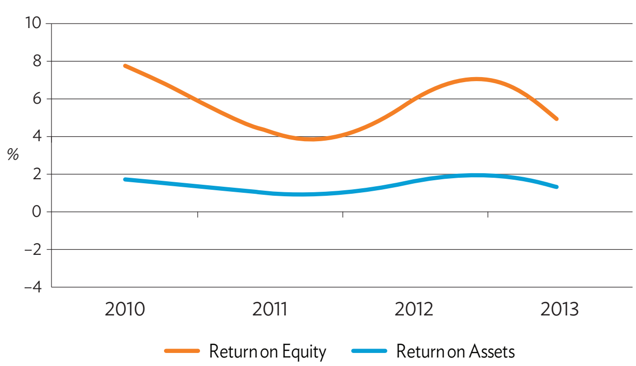
70 Based on a financial analysis undertaken by ADB. 2010. *Technical Assistance to the Republic of Vanuatu for the State-Owned Enterprise Rationalization Program.* Manila (TA 7588-VAN).

Figure 33: Vanuatu State-Owned Enterprise Portfolio Assets, FY2014 (Vt20 billion)



FY = fiscal year, Vt = vatu.
Source: Government of Vanuatu, Department of Finance and Treasury.

Figure 34: Vanuatu State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2010–FY2013



FY = fiscal year
Source: Government of Vanuatu, Department of Finance and Treasury.

only partially offset by Air Vanuatu's nonpayment of landing fees, which in turn is an unfunded CSO for AVL. AVL's average ROE was 1.3% in 2010–2014. Many airport SOEs struggle to cover their cost of capital in the Pacific due to high costs and low flight and rental income. It is possible that AVL's actual performance was worse than reported—the SOE received a qualified audit report for refusing to consolidate its 100% owned airport operating subsidiary.

Box 12: Air Vanuatu's Impact on Portfolio Results

Air Vanuatu (Operations) Limited (AVOL), with losses of Vt228 million in 2013 and Vt851 million in 2014, is the portfolio's biggest loser. An important factor in AVOL's losses are unfunded CSOs, estimated at almost Vt176 million for FY2013 alone. In 2014, management quantified the community service obligation (CSO) cost, seeking funding from the government in accordance with the approved SOE reform policy. The board, comprising chief executive officers from the ministries that would have to fund or approve the funding of the CSOs, have not progressed the CSO claim.

Public servants that are employed by ministries responsible for the state-owned enterprise, or its funding, should not serve on its board; they face an irreconcilable conflict of interest. Unfunded CSOs not only reduce profitability, but drain cash out of the state-owned enterprises and, if not addressed, will drive the SOE into insolvency. Such is the case with AVOL. By 2014, current liabilities exceeded current assets almost three times, total debt was Vt3,622 million and negative shareholding funds were Vt637 million.

There are a number of inactive SOEs that have not been included in the study:[71] **Vanuatu Livestock Development Limited (VLDL), Metenesel Estates Limited (MEL), and Vanuatu Commodities Marketing Board (VCMB) being the most significant.** MEL last produced audited accounts in 1993. Assets owned by these SOEs should be sold or leased to the private sector and the SOEs liquidated. Parliament passed the VCMB Repeal Act in 2011 directing the liquidation of VCMB, but so far no action has been taken. The Vanuatu Agriculture Development Bank (VADB) while active, has accumulated over Vt100 million in net losses since its establishment in 2008. It is technically insolvent with current liabilities exceeding current assets 2.7:1. Doubtful debts are 18% of total loans outstanding and 24.4% of shareholders' funds.[72] Both of these SOEs should be liquidated.

Vanuatu has successfully contracted the provision of power and water services to the private sector through concession contracts, currently undertaken by Union Electrique du Vanuatu Limited (UNELCO).[73] UNELCO provides electricity on Efate Island and the urban centers of Norsup, Malekula Island, and Lanakei, Tanna Island, and water in the capital Port Villa. A concession contract for power was

[71] These SOEs have failed to produce audited accounts for many years.
[72] As disclosed in VADB's 2013 audited accounts. At the time of writing, VADB's FY2014 accounts were not available.
[73] UNELCO is owed by GDF Suez (85.59%) and Electricite et Eau de Caledonie (14.4%).

first granted in 1939 for 40 years. A concession for 15 years was extended in 1986 and has been extended and expanded since that date to include water. UNELCO's concession for the provision of power on Espiritu Santos Island, representing about 12% of gross national generation, was tendered in January 2011 and won by a subsidiary of the United States-based Pernix Group Incorporated, Vanuatu Utilities & Infrastructure Limited. UNELCO's financial results are not publicly available, although its operating results are reported through two regional benchmarking studies[74] in which the company consistently scores well.

Lack of effective governance, oversight, and reporting and has resulted in poor financial returns. Before 2014, virtually no financial accounts were shared with the unit responsible for monitoring SOEs, the Government Business Enterprise Unit (GBEU)[75] within the Ministry of Finance and Economic Management (MFEM). GBEU lacks effective power, comprising just two staff members. SOEs report to the sector or line ministries and the sector minister is the responsible minister for all SOEs in his/her sector. The minister of finance has overall fiscal oversight and, in some cases, is a joint shareholding minister with the sector minister.

At 19%, Vanuatu has the second highest proportion of public servants serving as SOE directors in participating countries. All of the directors of Air Vanuatu Limited are public servants–appointed by the sector ministry, the Ministry of Finance, and stakeholder ministries. Appointing public servants to represent the ministries they are employed by creates a significant conflict of interest. In a number of cases when the SOE has produced timely accounts, they are not shared with the responsible ministries or the GBEU, but retained by the public servant director. The MFEM has the power[76] to instruct SOEs to produce accounts and to inspect records where accounts are not available, but it has never been exercised.

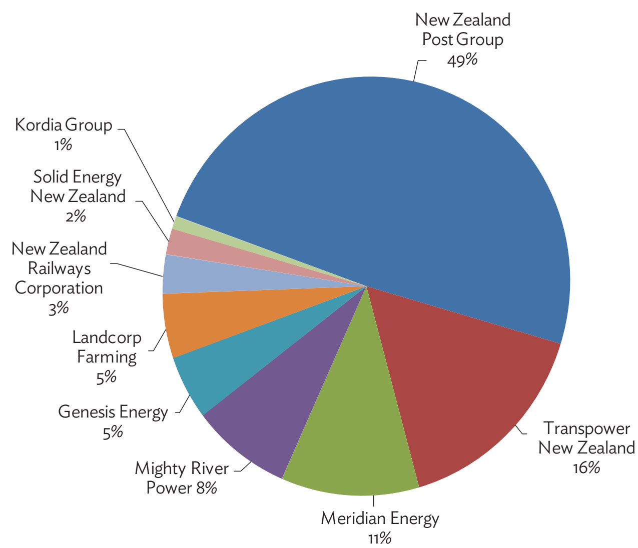
Recognizing the need to reduce the fiscal strain represented by the SOE portfolio and limit future contingent liability exposure, the cabinet adopted a broad-based SOE reform policy in October 2013. The policy requires SOEs to operate as commercial entities and provides a range of robust monitoring and governance mechanisms such as the appointment of an SOE minister, a framework for financing CSOs, business planning, and skills-based director-selection process. Implementation of the policy has been hampered by weak political commitment and exacerbated by the frequent changes in leadership since late 2014.

The government has prepared a SOE Bill based on the 2013 SOE policy, and intends to submit it to Parliament in 2016. The SOE Bill, if adopted as law, would provide much-needed support to the SOE reform efforts, appointing a minister to be solely responsible for all SOEs, prohibiting the appointment of civil servants and elected officials to SOE boards and requiring SOEs to generate a profit sufficient to cover their cost of capital. Implementing the SOE law, when enacted, along with the SOE policy principle of reducing the state's role in the economy[77] will have a strong positive effect on portfolio returns.

K. NEW ZEALAND

Recent trends in SOE performance in New Zealand demonstrate the risks of public ownership of commercial assets. From 2010 to 2014, New Zealand's 15 SOEs generated an average ROA of (0.4%) and ROE of (1.3%), one of only five countries in the survey generating negative returns. An early adopter of the SOE model, and one of the first countries to corporatize government departments, enact a comprehensive SOE Act, and undertake an aggressive privatization program, New Zealand's early experience was regarded as a resounding

Figure 35: New Zealand State-Owned Enterprise Portfolio Assets, FY2014 (NZ$35 billion)



FY = fiscal year, NZ$ = New Zealand dollar.
Source: Government of New Zealand, The Treasury.

74 Pacific Power Utilities Benchmarking Report 2012 & Pacific Water & Wastes Association Benchmarking Report 2013.

75 SOEs are termed commercial government business enterprises in Vanuatu.

76 Public Finance & Economic Management Act (No. 6) 1998, Section 62.

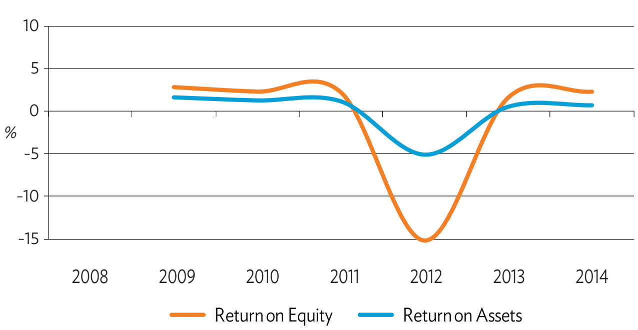
77 Vanuatu's SOE policy states that "the operation of commercial businesses is best left to the private sector" and once effective regulatory frameworks are in place to guard against the risk of private monopolies, the state will "divest of all of its commercial businesses." Government Business Enterprise Policy adopted 17 October 2013.

success. Many countries looked at this experience and attempted to duplicate it. That would not be the case today.

New Zealand Post, including its Kiwi Bank subsidiary, is the largest SOE with assets of NZ$17.5 billion representing 49% of the portfolio in 2014. The six largest SOEs comprise 92% of portfolio assets, but the three smallest SOEs—AsureQuality, Meteorological Services of New Zealand, and Quotable Value—have been the better performers in 2010–2104 with average ROEs of 25%, 16%, and 9%, respectively. Two SOEs in particular have dragged down portfolio performance—New Zealand Rail and Solid Energy—the latter generated losses of NZ$335.4 million in 2013 and NZ$181.9 million in 2014 and is currently in liquidation (Box 13). If these two SOEs were excluded from the portfolio, average ROA would jump to 1.5% and average ROE to 5.1% in 2010–2014.

In the mid-1980s, SOE reform was driven by fiscal need. New Zealand was badly affected by the twin oil shocks in the 1970s and early 1980s and the United Kingdom's entry into the European Economic Community in 1973. As a result the country's terms of trade were severely impacted. Default on foreign loans was imminent. A reforming government was elected in 1984 desperate for cash. The SOE portfolio—having never provided the government with dividends since establishment but rather was a cash drain—was targeted as a priority reform. A significant number were corporatized and then privatized (Box 14) and the balance was required to generate commercial returns comparable with private sector firms. The success of the reforms crossed party lines, empowering successive governments to pursue them. As the economy began to recover, public support for privatization waned, however, and with it political commitment. By the mid-1990s, the remaining SOEs were seen as the state's "crown jewels." The Labour government elected in 1999 mandated SOEs to use their cash to expand their businesses, and a number entered into questionable domestic and international

Figure 36: New Zealand State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2009–FY2014



FY = fiscal year.
Source: Government of New Zealand, The Treasury.

Box 13: Hero to Zero in Three Years: Solid Energy

Solid Energy aggressively expanded from early 2000, encouraged by its owner, the Government of New Zealand. The board estimated the company's value at NZ$3.5 billion in 2010.

By early 2013, the realizable value of the company's assets were less than its NZ$390 million debt and it was facing liquidation, laying off more than 25% of its workforce.

What went wrong? The company expanded while coal prices fell by 40%, and staff received bonuses while earnings dropped by 146%. The board failed to question management, and then refused to provide information to its shareholder: the government.

The failure of Solid Energy demonstrates the SOE model's inherent weaknesses, namely that without market discipline, boards, management, and staff take undue risks and run SOEs without attention to commercial performance.

Box 14: New Zealand's State-Owned Enterprise Reform Impact

State-owned enterprise reform commenced through corporatization and commercialization of activities previously undertaken by ministries or statutory bodies. The first 14 state-owned enterprises corporatized in 1987 achieved some spectacular gains in productivity and profitability. From 1987 to 1990, for example, Telecom New Zealand reduced staffing levels by 47%, increased productivity by 85%, and increased profits by 300%. New Zealand Railways Corporation cut its freight rates by 50% in real terms from 1983 to 1990, reduced its staff by 60%, and made an operating profit in 1989–1990, the first in 6 years. In the decade following its corporatization, New Zealand Post reduced its workforce by 40%, increased its volume of business by 20%, turned a NZ$40 million net loss into a NZ$48 million net profit without increasing the nominal postage rates. Coal Corporation increased productivity by 60% and cut its real prices by 20%.

From 1988 to 1999, a total of 47 privatizations raised NZ$19 billion, freeing up much-needed capital that was either reinvested back into core government services or used to repay debt.

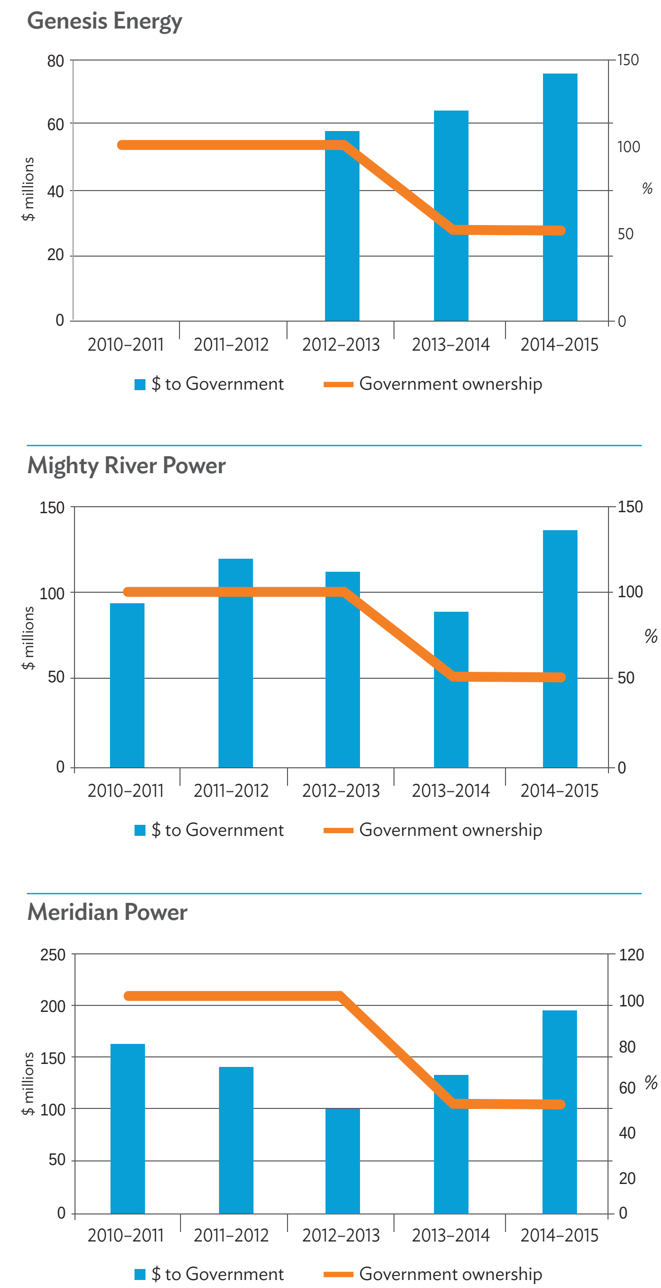
investments. New SOEs were also formed such as New Zealand Post's Kiwibank. When the conservative national government was elected in 2008, the SOE mandate was adjusted slightly, requiring that SOEs improve their commercial returns. However, privatization remained off the agenda until 2013.

Following the 2008–09 global financial crises, the government announced its intent to privatize the three large integrated electricity generator/retail SOEs—Mighty River Power Limited (MPR), Genesis Power Limited (Genesis), and Meridian Energy (Meridian). In part due to some public concern over privatization, the government announced that, rather than selling 100%, it would list the shares on the New Zealand stock exchange and, through an initial public offering, allow private individuals and investors to acquire up to 49%. Certain restrictions were imposed on the size of individual holdings.[78] Through this process the government sold 49% each of MPR[79] in May 2013, Meridian in October 2013, and Genesis in April 2014. The outcome was termed the "mixed ownership model."

The mixed ownership model has produced good results for the government and taxpayers. Not only did the government receive NZ$4,302.5 million from the sales, but dividend payments to the government have actually increased since partial privatization (Figure 37). Total dividends paid to the government in 2014 were NZ$406 million for their majority shareholding compared to dividends of NZ$269 million in 2013, the last year the government owned 100% of the three SOEs. As noted in a New Zealand Treasury briefing paper to shareholding ministers dated 14 May 2014, without the privatization program, "the Crown probably would not have received all of the dividends that the companies are now forecasting. There are strong pressures on listed entities to pay consistent, reliable and attractive dividends. The incentives on state-owned enterprises to pay dividends are much weaker." The briefing paper also noted that the privatization program created "incentives on the companies to improve their performance, which should result in greater dividends than would have been paid if the companies had remained 100% Crown owned."[80]

While the improved dividend payout was the result of a number of factors, the two most powerful drivers are aligned incentives and greater scrutiny. Privatization results in much stronger alignment in incentives between the owners, board, and management. All parties focus on wealth creation and wealth maximization. This occurs within, and is reinforced by, an environment of greater public scrutiny and informed comment.

Figure 37: New Zealand State-Owned Enterprises Privatized through Public Listing



Source: Government of New Zealand, Treasury annual reports and Pacific Private Sector Development Initiative analysis.

78 The Government of New Zealand also set targets for New Zealand ownership as part of the initial public offering process.

79 The Government of New Zealand's ownership of MRP is 52% at January 2016. The government did not participate in the company's 2013–14 share buy-back.

80 The New Zealand Treasury Briefing Paper is the NZ Treasury Briefing Paper to Cabinet dated 14 May 2014: Dividends from Genesis Energy, Mighty River Power and Meridian Energy.

Box 15: Privatizations and Nationalizations: Knowing When to Exit

In April 1989, Air New Zealand was sold by the Government of New Zealand for NZ$660 million.[a] In September 1990, the airline acquired 50% of Australian-based Ansett Holdings and, in February 1991, it acquired the remaining 50%. Ten years later, Ansett Holdings went bust, dragging Air New Zealand into serious financial difficulties: it reported a loss of NZ$1,500 million for that financial year. The government decided to support the airline and, in October 2001, agreed to inject NZ$885 million of new capital comprising a NZ$300 million loan[b] and the purchase of new shares for NZ$585 million. The loan was converted into ordinary shares in 2005.

Air New Zealand had a rights issue in 2004 and the government purchased an additional NZ$150 million shares. This, together with the conversion of the NZ$300 million loan into ordinary shares in 2005, brought its ownership stake up to 80%.[c]

Based on these numbers, it appears that the government made a poor decision. Having sold 100% of the state-owned enterprise for NZ$660 million, just 12 years later it had to inject NZ$885 million to keep the company flying.

As was the case with the government rescue of Air Jamaica, nationalizations come at a very high cost. The government mitigated this cost by not fully nationalizing the airline in 2001, but rather leaving an ongoing private shareholding and listing on the stock exchange. This provided important accountability and focus on profitability.

Since Air New Zealand's 2001 rescue, the government has collected NZ$765 in dividends and in 2013, received NZ$365 from the sale of 20% of its shares[a]—a cash return of NZ$1,130 million. Further, the government's remaining 53% has a market value of NZ$1,608 million based on Air New Zealand's share price of NZ$2.70.[a]

Governments sometimes rescue domestic corporations. As a result of the 2008 global financial crises, the Government of the United Kingdom financed bank restructurings through a mix of debt and equity, and the Government of the United States also provided financial support for banks and manufacturing firms like the General Motors. Stabilizing the firm's financial position can provide the board and management the breathing space needed to stabilize the firm's operating position. Experience shows that, once stabilized however, it is in the government's best interest to exit.

a The government's shareholding immediately after the rescue was 80%. This was progressively diluted to 73.2% in the period leading up to the 2013 sale through shares issues as part of the employee incentive scheme.

b The sale was announced as part of the mixed ownership model.

c Quoted on the New Zealand stock exchange on 3 December 2015.

The New Zealand experience supports a central theme of this study that, in the medium- to long-term, politicians are not good managers of commercial assets. As long as SOEs remain under public ownership, the risk of political considerations overtaking commercial imperatives exists. If governments are going to own commercial assets, however, the SOE model is probably the best available, despite its inherent weaknesses. Making the model work requires substantial political commitment, allowing the SOEs to operate at arm's length from the government, and holding both managers and the boards responsible for achieving commercial returns.

L. SINGAPORE

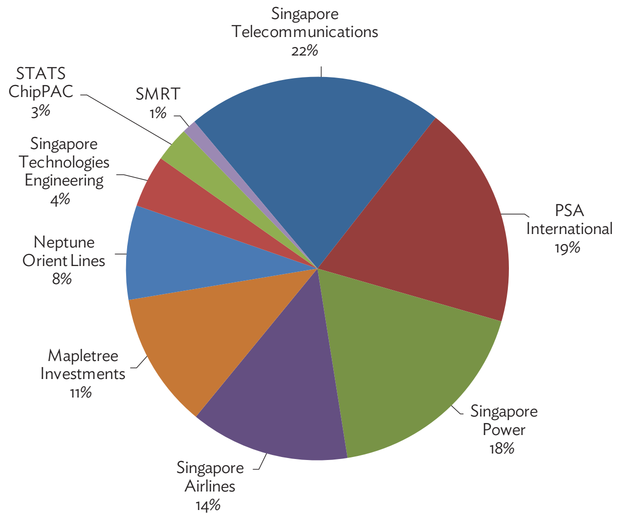
Singapore's nine SOEs are the strongest performers among the survey countries, with average ROE of 10.4% and ROA of 5.1% over the 2010–2014 period.[81] The portfolio is the largest of the survey countries—2.5 times the size of the New Zealand portfolio—and represents 8%–10% of total fixed capital in the economy. It contributed just 3.9% to GDP in 2014.

The five largest SOEs comprised 84% of the total portfolio assets in 2014, with Singapore Telecommunications alone representing 21.7%. The most profitable SOE, Singapore Technologies Engineering, achieved an average ROE of 27.6% over the period 2009–2014, but is one of the smaller SOEs, representing just 4.4% of total portfolio assets. Many of the SOEs, while being domiciled in Singapore, have significant assets and revenue-generating activities outside of Singapore.

Many of Singapore's SOEs were created in the 1960s to jumpstart industrialization following independence. The government's stated rationale was to compensate for the lack of private sector funds or expertise. A number of the early SOEs were established as joint ventures with foreign investors, rather than formed through the corporatization of government departments, as was the case in many of the countries in this benchmarking sample. In 1974, the government established Temasek and transferred 35 SOEs into the holding company structure. Since that time, Temasek has developed into a sovereign wealth fund: only 28% of its investments are now domiciled in Singapore. The balance are predominately located in other Asian countries, Europe, North America, Australia,

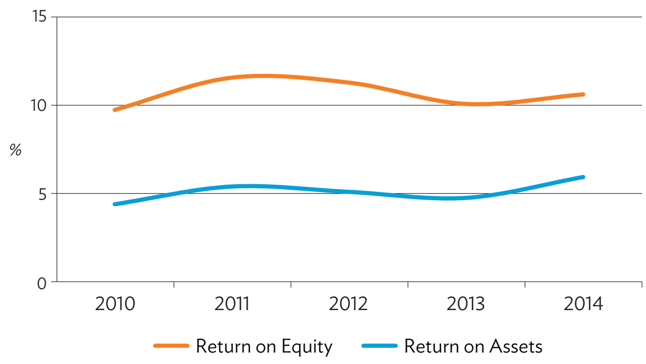
81 These SOEs are Singapore Telecommunications, Singapore Airlines, Singapore Technologies Engineering, PSA International, Mapletree Investments, Singapore Power, STATS ChipPAC, Neptune Orient Line, and SMRT Corporation Limited. To be included in this benchmarking survey, the SOE must be majority-owned by the government (through Temasek or directly) and have a commercial mandate. The nine SOEs are a subset of a larger number of SOEs in Singapore, termed government-linked companies (GLCs). An entity with a minority government ownership (under 50%) can still be termed a GLC if the government has a significant shareholding. Significant can be as low as 18%.

Figure 38: Singapore State-Owned Enterprise Portfolio Assets, FT2014 (S$94billion)



FY = fiscal year, S$ = Singapore dollar.
Source: Government of Singapore, Ministry of Finance.

Figure 39: Singapore State-Owned Enterprise Portfolio Return on Equity and Return on Assets, FY2010–FY2014



FY = fiscal year, S$ = Singapore dollar.
Source: Government of Singapore Ministry of Finance.

and New Zealand.[82] In 2014, SOEs comprised just 27.3% of Temasek's total assets of S$344 billion.

Singapore has an active privatization program, with over 41 divestments in the last 10 years. In January 1986, the government established the Public Sector Divestment Committee, with the mandate to review SOEs and develop a privatization program. The committee examined 99 entities,[83] recommending various privatization strategies to be undertaken over a 10-year period to ensure the market could absorb the number of SOEs being sold. Many of the SOEs were sold through a stock market listing. By 2014, the 30 SOEs[84] listed on the Singapore Stock Exchange comprised just 4% of listed issuers, but accounted for 30% of total market capitalization.

Singapore's SOEs and the Temasek holding company structure have been held up by many as representing good practice in SOE ownership. Certainly, there are aspects of the model that are consistent with good practice, as advocated in this study. A recent review[85] listed a number of drivers underpinning the SOEs' comparatively good performance:

- their ability to operate at arm's length from politics,
- listing on the stock exchange,
- exposure to international markets and competition,
- leadership continuity, and
- robust corporate governance practices.

The review noted that, unlike the challenges faced by SOEs in many other countries where performance suffers due to political interference, confused mandates, rent seeking—or where SOEs benefit from unfair advantages and political protection—this was generally not the case in Singapore. Temasek, the report notes, is an active shareholder, focusing on long-term maximization of returns without government interference in its business decisions. Listing SOEs on the Singapore stock exchange also promotes greater transparency and strengthened governance, leading to stronger financial performance.

However, it appears that Singapore's SOEs enjoy benefits that violate competitive neutrality and potentially inflate profitability. Five of the nine SOEs have an average gearing (debt to equity) in excess of 50%, with two being able to sustain a position where debt exceeds equity (Table 3). Many of the SOEs are also able to finance their business activities with free

82 Temasek 2015 investment profile. http://www.temasek.com.sg/

83 The entities comprised a mix of GLCs and activities owned by various ministries. The Public Sector Divestment Committee recommended that 41 be privatized, 6 be further reviewed, and 43 be retained by the state.

84 The 30 SOEs refer to 12 owned by Temasek and 18 owned by other SOEs. SOEs in this group may have a level of government ownership below 50%.

85 National University of Singapore. 2014. The State as a shareholder: The case of Singapore. *The Business Times*. 12 July 2014.

Table 3: Singapore Average Financing Ratios, 2010–2014

SOE	Debt to Equity (%)	Accounts Payable to Equity (%)	Debt and Accounts Payable to Equity (%)
NOL	147.2	49.1	196.3
STE	62.9	116.9	179.9
SP	147.1	21.3	168.3
SCP	93.2	15.8	109.0
SMRT	48.2	51.1	99.3
PSA	61.4	12.8	74.3
ST	33.1	20.3	53.4
MI	36.9	5.4	42.3
SA	9.6	31.1	40.7

SOE = state-owned enterprise.
Source: Annual financial statements of the SOEs.

cash: six of the SOEs have accounts payable—money owed to suppliers and customers through prepayment arrangements—averaging 20% or more of shareholder's funds. In two cases, accounts payable equate to around 50% of total equity and, in one case, over 115%. Why are suppliers willing to provide free cash? Research undertaken by the IMF in 2003[86] found that, while there appears to be "no basis for the lingering public suspicion that SOEs have easier access to credit", Singapore's SOEs are "being rewarded in financial markets with a premium of about 20%." The paper concludes that "the SOE premium has to reflect the market's perception of the benefits—whether real or illusory—of being linked to the government."

The high gearing explains in part why Singapore's SOEs generate comparatively high ROEs, but comparatively low ROAs. The average ROA of 5.1% in 2010–2014 is below Solomon Islands' ROA of 6.7% for the same period. A number of the SOEs also produced negative economic value added (EVA)[87] in the 2009–2014 period. EVA is a measure of a company's financial performance based on the residual wealth, calculated by deducting the cost of capital from its operating profit, adjusted for taxes on a cash basis. Value is created when the return on a company's capital exceeds the cost of that capital. When EVA is negative, a company is destroying shareholder value. Using this measure, Singapore Airlines destroyed S$4.3 billion of shareholders' funds in the 2009–2014 period, while Neptune Shipping Lines destroyed S$3.4 billion.[88] To compensate, three SOEs managed to generate over S$4 billion in positive EVA over the same period resulting in the portfolio achieving an average net positive EVA of just 2.44% in 2009–2014.[89]

While some of Singapore's SOEs achieved comparatively high ROEs, in a number of cases they still lagged well behind international sector benchmarks. Singapore Telecommunication's ROE of 15% in 2014 fell short of the industry average of 22%–36% as reported by market analysts.[90]Temasek Holding appears to be an effective SOE holding company structure, ensuring that the SOEs it owns on behalf of the government achieve high standards of governance and transparency; enforced in a number of cases through SOEs listing on the Singapore stock exchange, with a substantial proportion of shares held by private or institutional shareholders. There does not appear to be, however, a link between the share of private ownership and performance: both the best and worst performers have substantial (over 35%) private ownership.

Box 16: Does the Performance of Temasek Demonstrate That Governments Can Sustainably Manage Commercial Assets?

No, it does not. Temasek does provide a useful model for governments who seek to reduce risks associated with state ownership. It has been adopted to varying degrees in Malaysia and Viet Nam, and in 2015, the People's Republic of China announced it would move a number of its state-owned enterprises (SOEs) into Temasek-type structures. There is no evidence to suggest that Temasek's SOEs perform better than some others because of the inherent strengths of the Temasek model. Rather, it is because the Government of Singapore has determined that it wants its SOEs to produce commercial returns. There is nothing to stop the government from determining something different.

This political commitment, together with the SOE's exposure to competition and international markets, has been critical to the success of the SOEs. As has been demonstrated by New Zealand's experience, changes in political priorities can quickly erode the competitiveness of SOEs. As long as SOEs remain under majority state ownership, they will be subject to these risks.

86 C.D. Ramfrez and L.H. Tan. 2003. Singapore, Inc. Versus the Private Sector: Are Government-Linked Companies Different? *IMF Working Paper*. No. WP/03/156. Washington, DC.: IMF.

87 Adjustments to derive EVA are (i) add back interest cost (tax adjusted to Net Profit After Tax to derive Net Operating Profit After Tax, and (ii) add back accounts payable to net assets to derive economic book value. To calculate average EVA, the combined EVA totals over the period 2009–2015 were divided by average shareholder funds. EVA was developed by Stern Steward & Co.

88 Temasek announced the sale of its 67% holding in Neptune Orient Line in December 2015 for S$3.38 billion.

89 Calculated as a percentage of average portfolio equity 2009–2014.

90 See www.reuters.com/finance/stocks/overview?symbol=STEL; Telecommunication Service Snapshot–Fidelity 24 November 2015, 9:56am.

IV. CHALLENGES OF STATE-OWNED ENTERPRISE REFORM

A. HAS STATE-OWNED REFORM SUCCEEDED GLOBALLY?

State-owned enterprise (SOE) reform has been central to broader economic restructuring programs throughout the world, starting in Chile, New Zealand, and the United Kingdom in the 1980s. All programs aimed to improve performance by placing SOEs on a more commercial footing.[91] When countries experienced macroeconomic imbalances, the budget drain from SOEs became difficult to sustain. Many countries, therefore, initiated reform programs that ranged from attempting to commercialize SOEs to privatization.

The evidence shows, consistently, that despite repeated attempts at reform, endeavoring to impose commercial discipline on SOEs has rarely yielded satisfactory results over a sustained period. SOEs continue to underperform the private sector and, often, cannot operate without some government support. Even when strong commercial requirements were imposed on SOEs, after an initial period when productivity and profitability improved, the SOE portfolio performance steadily declined over time. Singapore's SOE portfolio, which is often considered to be one of the best performing in the world, benefits from implicit government support allowing it to sustain very high gearing rates (Section L). A number of Singapore's SOEs have in fact generated negative economic value added during the 2010–2014 period measured. Over the longer term, the ability of the Singapore portfolio to achieve ROE above 8% is also closely linked to the government's efforts to progressively shrink the portfolio and divest SOEs: over 41 SOEs have been privatized over the past 10 years.

In New Zealand, where SOEs initially dramatically improved their profitability after the reform program launched in 1984, the gains proved unsustainable. Reforms led to an average portfolio return on equity (ROE) of 8.7% by 2000, but performance steadily declined thereafter, with average ROE falling to 7.9% in 2000–2005, 4.3% in 2005–2010,[92] and (1.3%) in 2010-2014.[93] In 2012, the average ROE was a (15.1%), increasing to just 2% in each of 2013 and 2014.[94]

Box 17: State Capitalism in the Dock

In many countries, large state-owned enterprises (SOEs) that were floated or raised equity from 2000 to 2010 have performed poorly. Their share of global market capitalization has fallen from a high of 22% in 2007, to 13% by mid-2015. In the Russian Federation, Gasprom, which was once predicted by the Kremlin to be the first firm worth $1 trillion, was worth just $73 billion by mid-May 2015.

The troubles that have beset Brazil's Petrobas are well documented. Overall, SOEs among the world's top 500 firms have lost from 33% to 37% of their value since 2007.

What went wrong? Poor governance and accountability have been major contributors. Given license by politicians and with little need to satisfy investors, SOEs have been on a buying and investing splurge, accounting for over 30% of global capital investment. Balance sheets have grown faster than profits, dragging back returns on equity from 16% in 2007 to around 10% in 2015, with some major SOEs failing.

Source: *The Economist*, 17 May 2015.

Poor SOE performance is the norm for most countries. Government ownership provides weak incentives for efficiency, strong incentives for political accommodation at the expense of commercial outcomes, and political pressures to overstaff and undermaintain. Over time, many governments view SOEs not as commercial ventures, but as political liabilities. SOEs are managed to reduce political risks, not optimize commercial returns and operational efficiency.

This is the fundamental flaw in the SOE model: politicians always find difficulty with commercial decisions that have political costs. These costs include job losses, closing down loss-making businesses, or disallowing power and water utilities from charging true service costs. Politicians often see SOEs

91 Restructuring programs were usually associated with broader macroeconomic policy reform because SOEs frequently drained government budgets. For example, Jamaica, one of the most heavily indebted countries in the world, recently divested Air Jamaica, which was requiring budget support equivalent to nearly 2% of GDP.

92 Source: Government of New Zealand, The Treasury. Significant railway assets acquired from Ontrack were added to the SOE portfolio, which had a negative impact on returns for FY2007 and FY2008. The impact of Ontrack has not been discounted from these numbers because it was a government decision to reacquire the assets and add them to the SOE portfolio.

93 ROE was adversely impacted by a significant restructure of NZ Rail Corporation in 2012 (loss of NZ$2.13 billion) and Solid Energy in 2013 (loss of NZ$345 million). If these SOEs were removed, the portfolio average ROE in 2010–2012 would have been 5.1%.

94 The Government of New Zealand has recently reclassified its state-owned companies, combining the SOEs with other commercial state-owned companies to form a group labeled the "Commercial Priority Portfolio." This has not materially changed the portfolio's consolidated financial performance.

as entities that can accrue political patronage by providing community services without adequate compensation, or vehicles to employ their supporters. Rare is the government that will agree to allow necessary price increases for SOE outputs when elections are pending. Because of these inherent challenges to state ownership, the SOE model was never designed as a long-term ownership model, but as a vehicle to transition from state to private provision of services.

B. CHANGING HOW THE STATE SUPPLIES GOODS AND SERVICES: PRIVATIZATION AND PUBLIC–PRIVATE PARTNERSHIPS

The alternative to continued government ownership is privatization, which international experience demonstrates results in more efficient public service provision than state ownership. Privatization is the most effective means of locking in efficiency gains created by restructuring government departments into SOEs, and ensuring further improvements in operational performance.

Some argue that SOEs "belong to the people" and that selling them would be against the public interest. Yet public welfare is not determined by who owns SOE assets, but rather who benefits from the capital, plant, and machinery SOEs use. If assets under SOEs are used less productively than under private ownership, "the people" will benefit far more from their sale to private sector operators that can provide the services more efficiently.

From the mid-1980s to the mid-2000s, close to one trillion US dollars of SOEs were privatized in more than 100 countries. The bulk of privatizations occurred in the 1990s. Early adopters of large-scale privatization programs were Canada, Germany, Mexico, New Zealand, and the United Kingdom. By the mid-1990s, other regions had followed suit, most notably Eastern Europe and Latin America. Privatization resulted in improved performance and benefits to government budgets and user groups. Empirical evidence demonstrates that privatization improves business efficiency, boosts market competitiveness, and increases overall economic welfare. Twenty out of 22 academic studies on the effects of privatization observed that businesses performed better after privatization.[95]

Private ownership brought much-needed commercial discipline, capital, and expertise, as well as access to new markets. A 2004 study concluded "using return on assets as the measure of performance we find that the performance of SOEs is indeed inferior to that of private companies."[96] When transactions failed, they were usually poorly prepared or lacked regulatory frameworks to ensure that public monopolies did not become abusive private monopolies. A study on the performance of SOEs privatized through public listing in New Zealand and Australia found that, in New Zealand, after a 2-year holding period, the privatized portfolio had on average realized an 18.13% annualized return compared with the market index return of 8.09%. In Australia, the returns for a comparable period were 39.56% and 13.75% respectively.[97]

Privatization's economy-wide effects on government budget, growth, employment, and investment are also positive. Another study involving 18 countries with significant privatization programs reported substantial budget inflows from privatization, accounting for nearly 2% of annual GDP.[98] Although there were some short-term job losses as a result of privatization transactions, they were often offset by longer-term growth in the economies where the privatizations occurred. Community service obligations (CSOs), which are often found in infrastructure SOEs, can continue to be provided under private ownership, as demonstrated in Fiji and Tonga. All evidence suggests that Pacific countries that do not privatize their SOEs are foregoing major growth opportunities.

Competition increases through privatization. When the ground for competition is effectively prepared, privatization has been shown to increase competitiveness, and previously state-subsidized or state-favored businesses are forced to succeed (or fail) on their own.[99] More open and competitive markets in turn benefit consumers, taxpayers, and the economy as a whole.[100]

Privatization and public–private partnerships (PPPs) create market and investment opportunities for the private sector. By contracting out selected services, SOEs can enable smaller local firms, on their own or in joint venture with offshore parties, to bid for the new services. While it is often believed that privatization results in the sale of important state assets to

95 P. Barry. 2004. Does Privatisation Work? *Policy Backgrounder No. 5*. Wellington: New Zealand Business Roundtable.

96 E. Goldberg, L.A. Grunfeld, and G.R.G. Benito. 2004. The Inferior Performance of State-Owned Enterprises: Is it Due to Ownership or Market Structure? *Paper No. 663.* Oslo: Norwegian Institute of International Affairs, p. 20.

97 Privatization in New Zealand and Australia: an empirical analysis. *Managerial Finance*. Vol 34, No. 1, 2008.

98 N. Birdsall and J. Nellis. 2003. *Winners and Losers: Assessing the Impact of Privatization.* World Development Vol. 31, No. 10, pp. 1617–1633.

99 M. Gonenc, M. Maher, and G. Nicoletti. 2000. The Implementation and the Effects of Regulatory Reform: Past Experience and Current Issues. *Working Paper No. 251*. Paris: Organisation for Economic Co-operation and Development (OECD) Economics Department.

100 M. Shirley and P. Walsh. 2000. Public versus Private Ownership: The Current State of the Debate. *World Bank Policy Research Working Paper No. 2420*. Washington DC: World Bank.

Box 18: Unlocking Value in State-Owned Enterprises

To get an indicative market value of state-owned enterprises (SOEs), and hence the cash proceeds which could be generated through privatization, an earnings multiple methodology can be used.

Three SOEs were used to illustrate the potential cash proceeds, which could be generated from the sale of a 100% interest, adjusting for abnormal events, industry, and country risks. Based on 2014 audited accounts, the analysis revealed the following indicative values:

Fiji Electric Authority (FEA): $443 million
Tonga Communications Corporation (TCC): $26 million
Air Niugini: $169 million

In 2012, FEA was valued at $492 million and TCC at $40 million, using the same methodology. In the case of FEA, the decline in value reflects FEA's lower earnings caused by the ongoing drought affecting its ability to generate hydropower. In the case of TCC, the lower value reflects its substantially increased debt burden in 2014. In both cases, the declining equity values illustrate the inherent risks of government investment in commercial ventures.

foreign investors, 14 out of 21 full or partial divestitures of SOEs in the Pacific since 1998[101] were acquired by domestic investors. In Jamaica, local interests have invested in 14 of the 22 SOEs fully or partially privatized since 1999.

The experiences of all the countries participating in this study demonstrate that privatization transactions are successful when properly prepared. This includes prequalifying bidders, providing for potential employee redundancies, and introducing competitive tension in the sales process. Where privatization involves an effective or natural monopoly, regulatory frameworks must adequately protect consumers' interests. When these regulatory frameworks do not exist, partial privatization or PPPs may be the most effective mechanism for attracting investment and creating strong efficiency incentives.

There is significant value in SOEs in this survey. Substantial cash proceeds could be generated through partial privatizations, and even more through full privatization (Box 18). Fiji is preparing its electric utility and airport company for partial privatization, and Tonga is contemplating the same for its telecommunication provider. The potential for these types of transactions in the region is significant.

[101] No privatization transactions have been recorded in the Marshall Islands during this period, but there have been 10 in Samoa, 2 in Tonga, 4 in Fiji, 4 in Solomon Islands, and 1 in Vanuatu.

Box 19: Successful Partial Privatization in Samoa: Polynesian Blue

In Samoa, Polynesian Airlines was imposing substantial costs on the economy. In 2001–2002, it required an infusion of ST20million from the government to keep it running. These funds were provided by cutting spending on health and education. A joint venture was entered into with Virgin Australia that resulted in the formation of Polynesian Blue, with the government and Virgin Australia each owning 49% of the shares, with the remaining 2% being owned by a Samoan business. The result has been the elimination of the budget drain, lower airfares, and increased tourism.

Partial privatization can help accelerate commercialization and improve SOE performance. One of the most common forms of partial privatization is the joint venture, where the public and private sectors collaborate in forming a company to provide specific services. The partial privatization of Polynesian Air in Samoa (Box 19) produced dramatic and sustained improvements in service and efficiency, benefiting consumers and local tourism. Three of the best performing SOEs in the Fiji portfolio—Air Pacific, Air Terminal Services, and Fintel—all have substantial private ownership. While partial privatization has provided undeniable benefits to the Government of Fiji as shareholder, full divestment would have arguably provided even greater financial benefits, and eliminated its exposure to the SOEs' ongoing commercial risks (Box 20).

Some countries have adopted partial privatization combined with stock exchange listing to strengthen SOE's commercial focus and corporate governance. The mixed ownership model adopted in New Zealand[102] has assisted in better aligning board and management interests with shareholder interests, resulting in significant returns of capital. The mixed-ownership model is used extensively in Singapore and is being adopted in the People's Republic of China. As noted in a recent review, "based on fixed targets such as return on equity, state-owned enterprises are not performing very well. Some studies have even found that, if there had been no direct and indirect subsidies, many of them would be running at a loss."[103] To address this, and the consequences of its poorly performing SOEs, the People's Republic of China's State-Owned Assets Supervision and Administration Commission, announced four reform initiatives on 15 July 2014, one of

[102] For full discussion on the New Zealand experience with mixed ownership, see New Zealand country diagnostic on page 32.

[103] H. Shuli. Reform of SOEs critical to improve quality of Chinese economy. *South China Morning Post*. 14 August 2014.

Box 20: Partial Privatization in Fiji

Fiji has more partially owned state-owned enterprises (SOEs) than any other Pacific island country participating in this study. Prior to the full privatization of Fintel in 2013, Fiji's portfolio included four large SOEs with substantial private shareholdings: Air Pacific (49%), Air Terminal Services (49%), Fintel (49%), and Fiji Sugar Corporation (32%). Apart from Fiji Sugar Corporation, whose average return on equity (ROE) in 2002–2014 was (6%), the remaining three partially owned SOEs ranked among the top five performers in the Fiji portfolio. Air Pacific's average ROE in 2002–2014 was 13.4% and Air Terminal Services' was 10.6% for the same period. Fintel achieved 13.3% average ROE from 2002 until it was sold. Fiji's partially privatized SOEs performed better, on average, than its fully owned SOEs.

While partial privatization has benefits, continued government ownership exposes the government to ongoing commercial risk. The returns from Air Pacific have been erratic since 2002. The highest ROE recorded in 2002–2014 was 22% and the low was (4%); results bounced between those two extremes throughout the period. Fintel's ROE steadily declined from a high of 30% in 2002, to a low of (21%) in 2010, before recovering to 15% in 2012, just before its full privatization. Air Terminal Services' performance also showed a steady decline. Performance peaked in 2005, recording an ROE of 27% before falling to a low of 4% in 2012 and climbing back to 7% in 2014.

While performance drivers have been different for the three companies, in each case the government would have been financially better off if these three SOEs had been fully privatized at the time it decided to sell a minority of the shares.

them being the mixed ownership model. The State-Owned Assets Supervision and Administration Commission hopes that the introduction of private capital, and the disciplines that accompany it, will help drive improved SOE performance. Studies show that "the possibility of shareholders exerting both voice and exit may lead to higher profitability in [mixed enterprises], compared to 100% state-owned enterprises."[104]

Even when SOEs are partially listed on local and international exchanges, the inherent weakness of the SOE model eventually impacts performance. A study on the performance of Brazilian SOEs partially privatized and listed in 1976–2009 noted that, while the transformation from state owner and manager to majority shareholder has reduced many agency problems, it has not reduced government temptations to intervene in the operation of large strategic enterprises.[105] Partial divestment is rarely an effective long-term strategy for improving SOE performance, particularly when the government retains the majority or controlling ownership.

PPPs have been used extensively throughout the world to improve the quality and coverage of infrastructure services.[106] PPPs create strong performance incentives and allow the public and private sectors to share risks over time. Sometimes they include substantial private investment to upgrade and expand core infrastructure. The most common forms of PPPs include:

(i) **Service contracts.** The private sector provides a service, such as road maintenance or transport, for a fee.

(ii) **Management contracts.** The private sector manages, but does not own, public assets.

(iii) **Concessions.** The private sector modernizes public assets to deliver a specific output.

(iv) **Build-own-lease, or build-operate-transfer.** The private sector builds a new asset (such as a hospital or power generation unit). The asset is then leased back to the public sector (e.g., a hospital), or its output (e.g., power) is sold to the public sector or directly to consumers.

PPPs may or may not involve private financing of new or rehabilitated assets. In the Pacific, most PPPs have involved limited private financing, but this could change in the future with improved PPP legal frameworks, transaction structuring, and risk allocation.

Most countries in this study have had positive experience with PPPs, and plan more. Fiji, Papua New Guinea (PNG), Solomon Islands, and Tonga have contracted out subsidized ferry services to private sector providers. Fiji has a management contract for the Suva and Lautoka ports; Samoa successfully contracted out road maintenance services (Box 21), and developed a wastewater treatment facility on a design-build-operate-maintain basis. Solomon Islands privatized Sasape Marina through a PPP structure, leasing the facility to a private operator, which has made substantial investment to rehabilitate and expand services. PNG has developed PPP contracts for water supply and electricity generation, and is developing more for port operations. Its new PPP law will provide much-needed transparency and predictability to the PPP project preparation process, reducing risks for prospective investors and, therefore, costs for all involved. Jamaica is developing concession

104 C. Sam. 2007. Partial Privatization, Corporate Governance and the Role of State-Owned Holding Companies. *Journal of the Asia Pacific Economy*, 13, pp. 63–66.

105 M. Pargendler, A. Musacchio, and S. Lazzarini. 2013. In Strange Company: The Puzzle of Private Investment in State-Controlled Firms. *Harvard Business School Working Paper 13-071*. Boston, MA.

106 A PPP is not a joint venture; it is a shared-risk contract between the public and private sectors to deliver a specific output over a period.

Box 21: Privatizing Road Maintenance in Samoa

In 2001, Samoa decided to contract out all road construction and maintenance activities previously undertaken by the Public Works Department (PWD). The reform has been an outstanding success. Since 2001, nearly 30 new firms have been established to do road construction and maintenance, and the government estimates a 400% increase in productivity. Before the reform, much of this work was either undertaken by the PWD, or by foreign companies under contract. All of the work is now outsourced to Samoan companies, which are now sufficiently productive that foreign firms struggle to compete. An estimated 2,000 new jobs have been created,[a] demonstrating that successful contracting out promotes economic development and increases employment opportunities.

[a] PWD employed 600 staff in the 1990s. The Land Transport Authority estimates that, in 2014, over 2,600 Samoans are engaged in activities previously undertaken by the PWD.

agreements for the Norman Manley Airport and Port of Kingston, involving a total investment of over $500 million, and another PPP is already in place at Jamaica's largest airport in Montego Bay. In Mauritius, the government has developed a PPP framework that has been recently strengthened, anticipating an expansion of the PPP transaction pipeline.

PPPs can generate real benefits, and simple contracts are not costly. Countries should continue exploring PPP opportunities in the SOE portfolio, so that bankable PPP projects can be implemented and new opportunities identified. Critical to the success of PPPs, or joint ventures with SOE participation, are robust governance arrangements, full transparency, and arms-length relationships with governments—consistent with SOEs' commercial mandates.

C. IMPROVING STATE-OWNED ENTERPRISE PERFORMANCE

SOEs either suffer from too much political interference or too little ownership oversight, both of which result in poor performance. Governments have addressed the fundamental flaw in the SOE model by creating legal, governance, and monitoring frameworks to mimic the conditions and incentives that private sector firms face. This has been done using different approaches.

Box 22: Expanding the Use of Public–Private Partnerships in the Pacific

A 2015 survey[a] of private participation in the provision of infrastructure services in the Pacific revealed over 30 separate contracts currently in place. A portion of these, 39%, were for the provision of garbage/landfill/solid services, 23% for water-wastewater-sewage services, 10% in the power sector, 16% in road maintenance and water transport, and the balance of 12% in ports.

Public–private partnerships ranged from simple service contracts for garbage collection (Fiji, Papua New Guinea [PNG], Samoa, and Solomon Islands), road maintenance and shipping (Fiji, PNG, Samoa, Solomon Islands, Tonga, and Vanuatu), to long-term concessions for the provision of power, water, and port services (PNG and Vanuatu).

The shipping projects have focused on the provision of services to remote communities, along with allied infrastructure (rehabilitation of piers, pontoons, jetties, landing ramps, and small wharves). In a number of cases, the provision of these services has created demand among the target communities, progressively reducing the amount of subsidy required to make them commercially viable.

Long-term concessions for the provision of power and water services in the major urban centers of Vanuatu has resulted in reliable and good quality services, albeit the value for money of the contracts is difficult to assess in the absence of a competitive tendering process.

Four of the water sector projects (the Marshall Islands, Federated States of Micronesia, Palau, and Samoa) have been developed under a similar design-build-operate-maintain model, which holds further potential in the Pacific. In this model, the public sector finances the capital investment which, however, is designed, built, and operated by the private partner, who is incentivized to design a facility that can be operated and maintained as efficiently as possible.

Overall, the survey reveals that the Pacific experience with PPPs has been largely positive, with few instances of contracts being rescinded or resulting in poor outcomes for the public sector. With the exception of Vanuatu, most contracts have involved limited private investment, but this is set to change as countries gain more experience with the development and management of PPP contracts and the underlying legal and regulatory frameworks in support of these structures are put in place.

[a] Pacific Private Sector Development Initiative. Pacific PPP Summary. January 2016 (draft).

There is no consistent legal or institutional framework for SOEs in the countries in this study. In the Pacific, the rules governing SOE behavior are usually established through an overarching SOE Act based on the New Zealand State-Owned Enterprise Act of 1986. While the New Zealand Act may have provided the template, those recently adopted in the Pacific have improved upon the original. This is true for the SOE acts of Kiribati, the Marshall Islands, Samoa, Solomon Islands, and Tonga, each of which set common standards and rules on SOE establishment, disestablishment, governance, reporting, management, oversight, and commercial objectives. The SOE legal frameworks in Jamaica, PNG, Mauritius,[107] and Singapore comprise a mix of legislation and codes, but they set no clear commercial objective for their SOEs.[108] All of Singapore's SOEs are companies—some are listed on the stock exchange—and many SOEs in other countries are also companies, benefiting from governance and other provisions contained in their company laws.[109]

A comprehensive SOE legal framework does not itself guarantee improved SOE performance. Individual examples of successful SOEs[110] can be found in every country participating in this study, even where the formal legal, governance, and monitoring frameworks are weak. Conversely, countries like Samoa, which have robust SOE legal, governance, and monitoring frameworks, can generate consistently poor results. New Zealand, which has had an effective SOE law for over 30 years, has seen SOE performance steadily decline from 2002 to 2012. The determining factor is the political will to require SOEs to make a positive rate of return and hold them accountable for results. When this will exists, a robust SOE legal framework facilitates commercial outcomes. When the will does not exist and SOE laws are ignored, poor performance becomes acceptable and positive change is resisted.

There is strong evidence of a positive correlation between good corporate governance and performance.[111] A recent study reviewing financial performance of listed companies in an emerging market found that during the 2007–08 global financial crises, better-governed companies outperformed companies with weak corporate governance standards.[112] In the long run, good corporate governance rests squarely on a foundation of law and regulation.[113] Under a sound legal framework, laws that govern business transactions can do much to support commercial activity. Business laws establish enforcement mechanisms and provide templates for commercial transactions that reduce transaction costs. Countries and regions in which legal systems function effectively have an advantage in encouraging investment, both local and foreign, over those countries where the law is opaque, slow, and costly. Although SOEs have the state as their sole or primary shareholder, the same principles apply. A sound legal foundation will, if well implemented, promote more effective operation.

Increasingly, countries are introducing legislation, ownership policies, governance practices, and monitoring structures to place SOEs on a firm commercial footing.

Box 23: Features of Robust State-Owned Enterprise Legislation

State-owned enterprise (SOE) legislation should cover:

- SOE establishment;
- SOEs' primary commercial objective;
- selection, appointment, and removal processes for directors;
- directors' roles and responsibilities;
- conflict of interest management;
- chief executive officer appointment;
- responsible and shareholding ministers' roles;
- content and approval process;
- business/corporate plans;
- statement of corporate objectives/intent;
- annual (and semiannual) reports;
- audit requirements;
- performance review/audit,
- reporting requirements to parliament and public accountability; and
- definition, approval, costing, contracting, and funding community service obligations.

107 The SOE legal framework in Mauritius includes the Companies Act, Financial Reporting Act 2004, Statutory Bodies (Accounts & Audit) Act 1972, and the Code of Corporate Governance for Mauritius.

108 The SOE laws in Jamaica and Cape Verde lack many core provisions—focusing mainly on financial, reporting, and audit. The framework in Mauritius contains many of the provisions found in a comprehensive SOE Act. Singapore's Temasek Holding sets financial and performance targets for the SOEs it owns, but the targets are not set in legislation.

109 Appendix 4 summarizes SOE legal frameworks in each country in the study.

110 Air Terminal Services, Eda Ranu, Fiji Electricity Authority, Marshall Islands Development Bank, Mauritius Airports, Port Authority of Jamaica, Samoa Shipping Corporation, Solomon Island Electricity Authority, and Tonga Power.

111 S. Bhagat and B. Bolton. 2006. *Board Ownership and Corporate Governance Indices*. Boulder: University of Colorado & Bolton.

112 O. Kowalewski. 2012. Does Corporate Governance Determine Corporate Performance and Dividends During Financial Crises: Evidence from Poland. Warsaw: Kozminski Centre for Corporate Governance, Kozminski University.

113 See, for example, G. Walker and T. Reid. 2002. Upgrading Corporate Governance in East Asia. *Journal of International Banking Law*, p. 3.

- **SOE legislation:** Since 2005, new or significantly enhanced SOE laws have been adopted or developed in Cape Verde, the People's Republic of China, Finland, Hungary, Kiribati, the Republic of Korea, the Marshall Islands, Namibia, Norway, PNG, Poland, Portugal, Samoa, Solomon Islands, Spain, Switzerland, Tonga, Tuvalu, and Viet Nam.
- **Ownership rules and disclosure.**[114] Since 2005, rules or guidelines have been introduced in Finland, Norway, Poland, Portugal, the Republic of Korea, Samoa, Spain, Tonga, and Vanuatu defining the state's ownership role, establishing SOE performance criteria, and increasing the transparency of reporting relative to performance targets. The Republic of Korea has introduced an online system to provide real time information on SOE's financial and nonfinancial performance; New Zealand has adopted a continuous disclosure regime for its seven largest SOEs; and Finland, France, Ireland, New Zealand, Norway, Sweden, Tonga, and Turkey now produce comprehensive public reports on their SOEs' performance, performance criteria, and the major policies that apply to the SOEs' operation and control.
- **Governance practices and expectations.** Codes of practice that incorporate conflict of interest guidelines, skills-based board selection and appointment requirements for SOE boards, and rules limiting the ability of politicians to direct SOEs have been introduced in over a dozen countries. The Organisation for Economic Co-operation and Development (OECD) updated its Guidelines on Corporate Governance of SOEs in 2015,[115] and noted the increasing trend for countries to publicize their rationale for continued state ownership of individual SOEs, allow SOEs full operational autonomy, manage their ownership interests through a central agency, and allow SOE boards to operate within a clear mandate defined in legislation. A summary of the main recommendations from the 2015 update of the Corporate Governance Guidelines for SOEs is contained in Appendix 5.
- **SOE monitoring structures.** Increasingly, governments are moving towards a centralized monitoring structure, achieving a proper separation of the ownership function from regulation and purchase. Centralized monitoring also enables the development of specialized SOE ownership monitoring expertise. Kiribati, Malaysia, New Zealand, Samoa, Singapore, and Tonga have adopted this model, and it is also increasingly being used in Latin America.[116]

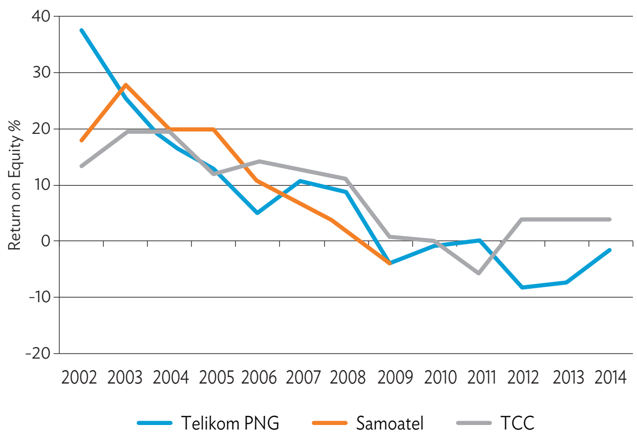
D. ESTABLISHING COMPETITIVE NEUTRALITY

SOEs profitability is not always due to operating efficiency but may result from monopolies that are enshrined in law. SamoaTel, Tonga Telecommunications Corporation (TCC), and Telikom PNG are examples of SOEs that accounted for a large part of the profits of their country's SOE portfolios. Once competition was introduced, the financial performance of all three SOEs fell dramatically (Figure 40).[117]

The principle of competitive neutrality requires that the same competition criteria should be applied to SOEs as to private companies. Monopoly rights and privileges granted to SOEs shelter them from market forces, so that their profitability could result solely from their market power. SOEs should not enjoy competitive advantages over their private sector competitors—without objective justification—simply by virtue of their state ownership. Lack of competition weakens SOE incentives to improve efficiency and profitability.

In small island economies, many SOEs are monopoly providers in their markets, such as water, electricity, airports, and ports. In some cases, technology is breaking

Figure 40: Competition Impact on Telecommunication State-Owned Enterprise Profitability



PNG = Papua New Guinea, TCC = Tonga Telecommunications Corporation.
Source: Annual financial statements of the SOEs.

[114] See Appendix 3: Overview of State-Owned Enterprise Legal, Governance, and Monitoring Reforms, 2005–2014 for an expanded list of reforms since 2005.

[115] OECD. 2015. *Guidelines on Corporate Governance of State-Owned Enterprises: 2015 Edition.* Paris.

[116] World Bank. 2013. *Corporate Governance of State-Owned Enterprises in Latin America.* Washington, DC.

[117] For SamoaTel, privatization in 2010 brought in much-needed capital and management expertise, allowing it to more effectively compete. TCC's performance continues to decline as the government debates whether to privatize it.

Box 24: How Is Competitive Neutrality Applied to State-Owned Enterprises?

- State-owned enterprises (SOEs) have no preferential access to government contracts, nor requirement to deliver community service obligations without market-based compensation.
- There is no government guarantee or soft loans for SOEs.
- Government equity is priced as in comparable private firms.
- SOEs are subject to the same labor and tax rules as the private sector.
- SOEs do not benefit from protective barriers.

Box 25: Features of Effective State-Owned Enterprise Ownership-Monitoring Frameworks

- A centralized independent monitoring agency focused on holding state-owned enterprise (SOE) boards accountable for performance
- Financial and nonfinancial performance targets
- Monitoring based on SOE corporate and business plans
- Rewards for good performance and penalties for poor performance, based on agreed performance targets
- Timely public disclosure of SOE performance

down barriers to competition, and governments must ensure policies support competition rather than protect incumbent SOEs. The Trans Pacific Partnership contains provisions prohibiting signatory countries benefiting their SOEs through anticompetitive practices.

The most effective way of dealing with this problem is to establish a legal framework supporting competition, including competition by SOEs. For example, all SOEs in the European Union are subject to its Competition Framework (Box 24). The European Union adopts a comprehensive legal framework supporting competitive neutrality. SOEs are not to receive subsidies, grants, or other types of favorable financial treatment that would favor them over competitors that do not benefit from state support. Pacific countries are still developing these institutional structures, with Samoa leading the way. Samoa's Competition and Consumer Act 2016 (when it comes into effect) will apply equally to SOEs and to private sector businesses, promoting a level playing field on which each can compete.[118]

E. COMMUNITY SERVICE OBLIGATIONS AND STATE-OWNED ENTERPRISE PERFORMANCE

In most countries in our sample, SOEs are required to provide services to communities on noncommercial terms. Such services, which are known as CSOs, are sometimes only partially compensated, or SOEs are expected to provide them with no compensation. For others, there is compensation, but there is no competitive tendering. Both practices have negative impacts on the SOE and the government purchaser. If there is incomplete compensation, SOE performance is negatively affected through reduced rates of return, providing SOE management with an excuse for poor performance. In Jamaica, Kiribati, the Marshall Islands, Mauritius, and Vanuatu, CSO frameworks are poorly defined, unequally implemented, and a major cause of poor SOE performance. The CSO process in Solomon Islands, in contrast, is robust and has contributed to the portfolio's relatively strong performance. In 2014–2015, PNG piloted its CSO policy with one SOE, and plans to extend the process to more in 2016. The full implementation of the CSO policy will provide increased transparency, allow the SOEs to focus on achieving a commercial return, and, ultimately, allow the government to choose among a range of CSO suppliers, enhancing value for money.

Solomon Islands demonstrates benefits from its CSO framework. The CSO contracting process implemented since 2011, when the first CSO contracts were negotiated with the Solomon Islands Broadcasting Corporation and Solomon Islands Electricity Authority (SIEA), has been fundamental in the improved financial and operational performance of its SOEs. By 2014, five SOEs[119] participated in the CSO program, sharing the SI$39 million government funding. Identifiable benefits include:

- **Financial recovery:** The average ROE for SIEA improved from (5.9%) in 2007–2010 to 13.6% in 2011–2014, while the Solomon Islands Water Authority's average ROE improved from (24.6%) to 12.6% over the same period.

118 In addition, ministers must consider the effects on competition in Samoa of any government decisions in which they participate. To assist ministers in this, the new Competition and Consumer Commission must report on the competitive effects of proposals, when requested to do so.

119 Solomon Airlines, Solomon Islands Broadcasting Corporation, Solomon Islands Electricity Authority, Solomon Islands Postal Corporation, and Solomon Islands Water Authority.

- **Improved financial controls:** Preparation of CSO cost estimates forced the SOEs to improve financial management and reporting and better quantify and manage their costs.
- **More efficient operations:** The CSO negotiation process forces the government and SOEs to examine costs and operating performance. Inefficiencies are more readily identified and, as part of the CSO contracting process, incentives are introduced to eliminate them.
- **Reduces systemic cash flow problems:** CSO funding provides cash to enable SOEs to reinvest back into operation and infrastructure.
- **Catalyst for a sustainable business:** Activities that were unprofitable and requiring CSO support can, with the correct incentives, develop into profitable activities eliminating the need for ongoing CSO funding. Through this process SIEA's need for CSO support fell from SI$39.1 million in 2011 to SI$13.7 million in 2016.
- **Improved service provision:** CSO funding, supported by incentive arrangements in the CSO contracts, has enabled SIEA and SIWA to significantly improve service availability and quality.

Compensation for CSOs without competitive tendering violates competitive neutrality. CSO policies should require competitive tendering. CSO rules often contemplate an SOE providing the good or service, rather than seeking alternative providers. Competitive tendering ensures public money is spent effectively and paid to the most economically advantageous CSO provider. The next step in implementing CSO frameworks in the Pacific will be to invite proposals from private providers.

F. GOVERNANCE AND MONITORING

The 2007–08 global financial crisis revealed how failures in corporate governance can ruin firms and have an economy-wide impact. Studies undertaken after the crisis show that stronger-governed firms performed better during the crisis compared with those firms with comparatively weaker corporate governance structures. This study demonstrates that SOEs that have adopted robust governance practices tend to perform better over time than those that do not.[120] Good corporate governance should maximize firms' contributions to the overall economy. This principle fits neatly into the objective of maximizing the rate of return on assets (ROA) controlled by SOEs.

Governance practices designed to improve reporting, accountability, and independence from political interference have boosted SOE performance in the Pacific. Removing elected officials from SOE boards and introducing skills-based director selection and appointment have been important developments. While they have not eliminated the risk of political interference, they have made such interference more difficult and more transparent. Similarly, mandating corporate planning and reporting processes has made it easier to hold SOEs accountable for performance. SOE board composition in the survey countries (Table 4) illustrates that all but two countries in the survey have removed all elected officials from SOE boards. As these are relatively recent developments, it is too early to see their impact on SOE portfolio performance, although the two countries that continue to have elected officials on SOE boards—Jamaica and the Marshall Islands—record the lowest ROAs in 2010–2014.

Women continue to play a minority role in SOE boards and management although there are positive developments in some pacific island countries. Jamaica and Kiribati have the highest percentage of women on SOE boards. The percentage of female directors increased in the period 2012–2014 in the Marshall Islands, PNG, and Samoa but declined in Fiji, Jamaica, and Tonga. Efforts to expand the pool of women available to serve on SOE boards, as is being undertaken in Solomon Islands, Samoa and Tonga, should be encouraged to enrich the mix of skills and experience available to SOEs.

Robust ownership monitoring practices protect the state's investment in SOEs. Globally, there are three ways to monitor SOE performance. These can be summarized as the decentralized, dual, and centralized models.

(i) **In the decentralized model, the sector or line ministry monitors performance and reports to the minister.** The minister of energy, for example, would be responsible for the electricity SOE and would act as the performance monitor. This model has weaknesses: the minister has a conflict of interest in balancing the roles of sector regulator and owner. Since other ministries will also have SOEs in their mandate, monitoring skills will be spread among the various ministries and there is no coordinated SOE oversight or policy.

(ii) **In the dual monitoring model, the sector ministry and ministry of finance share the monitoring oversight role.** This is to reduce the sector minister's conflicts of interest. The advantage of this over the decentralized model is that the government is better able to take a "whole of government" view of its SOE portfolio, consolidate financial reporting data, and

[120] Examples of comparatively better performing SOEs with robust corporate governance practices include Air Pacific, Marshall Islands Development Bank, National Bank of Vanuatu, Tonga Development Bank, Tonga Power Limited, Samoa Shipping Corporation, and Solomon Islands Electricity Authority.

Table 4: State-Owned Enterprise Board Composition, 2015

	Fiji	Jamaica	Marshall Islands	Kiribati	New Zealand	Singapore	PNG	Samoa[a]	Solomon Islands	Tonga	Vanuatu
Number of SOEs	25	17	11	18	15	9	11	29	8	15	17
Number of directors	99	185	70	82	101	93	95	188	52	37	104
Female directors (%)	5	26	24	25	36	10	16	21	13	16	5
Female directors in 2012 (%)	10	31	22	NA	NA	NA	10	18	13	17	NA
Number of elected officials serving as directors	0	4	24	0	0	0	0	0	0	0	0
Number of public servants serving as directors	13	23	14	24	0	0	6	11	2	5	20
Elected officials/public servants on boards (%)	13	15	54	29	0	0	6	6	4	14	19
SOEs with female chairs (%)	4	NA	9	NA	53	0	9	7	0	7	NA
SOE Portfolio ROA 2010–2014 %	1.5	(2.3)	(3.7)	2.8	(0.4)	5.1	1.3	(0.3)	6.7	2.6	(0.1)

( ) = negative, NA = not available, PNG = Papua New Guinea, ROA = return on assets, SOE = state-owned enterprise.

[a] Samoa SOEs include public trading bodies and public beneficial bodies.

Note: Total number of SOEs and directors as of October/December 2015.

Source: Country surveys and responses gathered by the authors.

develop economy-wide SOE policies and practices. The weakness is that the sector minister still retains significant control. Ownership monitoring is still spread among multiple ministries, diluting expertise. The ministry of finance also has a conflict, being responsible for fiscal discipline and oversight of the SOE portfolio. This model is found in many Latin American countries as well as Cape Verde, Fiji, Jamaica, Mauritius,[121] Solomon Islands, and Vanuatu.

(iii) **The centralized monitoring model relies on an SOE ministry or a monitoring unit within the Ministry of Finance or Prime Minister's Office reporting to a minister, independent of any line or sector ministry, and responsible for all SOEs.** Holding companies can also be formed to fulfill this role, as in Hungary, Peru, PNG, and Singapore.[122] In Finland, the central ownership monitor sits within the Prime Minister's office, but reports to the minister of defense: no SOE is involved in defense, so that the minister has no conflicts of interest. Some private sector firms may be contracted to undertake the ownership-monitoring role or provide specialist support for the centralized monitor.[123]

The benefits of centralized monitoring are increasingly recognized: a growing list of countries has adopted this model: Australia, Austria, Belgium, Denmark, France, Malaysia, the Netherlands, New Zealand, Norway, Poland, Singapore, Spain, Sweden, and Viet Nam.[124] Use of a centralized ownership monitor is growing in the Pacific, and includes Fiji, Marshall Islands, New Zealand, PNG, Samoa, and Tonga.

Ultimately, SOE oversight is about establishing checks and balances—getting the correct balance between the state's exercise of its ownership rights and the board's authority to implement the commercial mandate. A centralized ownership-monitor does not guarantee better SOE performance, but it does facilitate effective monitoring. To improve SOE performance, the owner must act on the monitoring output and hold boards to account.

[121] Fiji centralized SOE monitoring within the Ministry of Public Enterprises in 2014. Previously, the responsibility was shared with the Ministry of Finance. Sector or line ministers still share ownership responsibilities and are the responsible ministers. For this reason, Fiji is included within the dual monitoring model.

[122] In PNG, a trust owns the SOEs and the trustee is a government owned company. The SOE holding company in Singapore—Temasek Holdings—began as an SOE holding company but now operates as a sovereign wealth fund with the majority of its investments outside Singapore. In Viet Nam, corporatized SOEs are transferred into a central SOE holding entity—the State Capital Investment Corporation.

[123] The Auckland Regional Services Trust, a SOE holding company, contracted private sector experts to support its monitoring function.

[124] Forfas. 2010. *The Role of State Owned Enterprises: Providing Infrastructure and Supporting Economic Recovery*. Dublin.

G. CREATING DEMAND FOR REFORM

That SOE reform is not possible without political commitment is well understood, the challenge is to create and sustain that commitment. No country has been successful in sustaining SOE reform over the long-term. In the countries participating in this study, reform cycles vary between a year to a decade. They are driven in some cases by fiscal need, and in others by public demand for improved services.

- **Fiscal need:** New Zealand's imminent failure to meet its foreign debt obligations in 1984 led to significant SOE reforms that continued through to the early 1990s. It was not until the global financial crises in 2008 that privatization was again on the agenda (Section K). Fiscal constraints have been cited by most of the countries in this survey as a factor underpinning reform.
- **Improved services:** The poor performance of SOEs in delivering core infrastructure services to the public, in particular to remote parts of the Pacific, puts pressure on governments to reform.

This has been particularly true in PNG and Tonga. Tonga is the only country in the survey that publishes summaries of SOE performance in local newspapers, although this is also a legal requirement in Solomon Islands. Transparency drives accountability. Tonga's SOE minister acknowledges that public awareness of SOE performance and SOE reform-related issues has increased in Tonga since this requirement was introduced in 2010, and has been a factor in supporting political commitment.

Development partners also play a role in improving SOE performance, but poorly defined assistance programs can hinder rather than promote reform. Grants and concessional loans can provide countries with short-term solutions undermining the focus, and imperatives, for structural, long-term reform. Capital equipment grants to SOEs, for example, can distort markets, reduce incentives for efficiency, and undermine private sector development. In Tonga, donor-gifted rubbish collection trucks were used by SOEs to compete against existing private sector operators, leading some to exit the market. Where donors seek to support the expansion of infrastructure services, this could be done in a less distortionary way by making this assistance available to all service providers on a competitive basis.[125]

Development partners can also encourage SOE reform by setting material reform targets as conditions to their financial support. Budget support programs undertaken in a number of Pacific island countries attempt to set SOE reform targets—agreed with the respective governments—with varying success. A stronger link between donor funding and the attainment of agreed reform targets is needed. Donors should be prepared to hold back funding when targets are not met.

There is no simple way to create demand for sustained SOE reform, but disclosure is an essential component. While political imperatives change overtime, increased transparency will support reform. Establishing government websites dedicated to SOEs would be a meaningful first step, allowing the public to access annual accounts, planning documents, performance reports, identity of directors and their remuneration, CSOs and their costing, and other relevant and material information. An informed public is key to creating and sustaining demand for SOE reform and holding politicians accountable for success.

Box 26: Singapore's Temasek: The Gold Standard?

Countries aspiring to improve the performance of their state-owned enterprises (SOEs) often look to Singapore as a potential model to follow. Singapore's SOE are held through Temasek Holdings, a private limited liability company owned by the Government of Singapore. It was established in 1974 and now owns investments valued at S$344 billion, of which only 37% are SOEs.

The SOEs owned by Temasek achieved an average return on investment of 10.4% in 2010–2014, the highest of the countries in the survey group, ahead of second ranking Solomon Islands at 10% and well ahead of New Zealand at(1.3%). When assessed on return on assets, Solomon Island's SOEs, with an average of 6.7% in 2010-2014, outperformed Singapore's SOEs at 5.1%, reflecting the Singapore portfolio's generally higher gearing. When measured by government transfers to gross domestic product, SOEs in Kiribati and Tonga returned more to their respective governments than Singapore's SOEs.

There is no evidence to suggest that the Temasek model produces better returns than all other SOE ownership models, but it does have comparative strengths in governance and transparency which are worth studying.

[125] This approach has been used under output-based aid programs, and could be expanded in the Pacific.

V. GOOD PRACTICE AND THE WAY FORWARD

This study has demonstrated that, in many countries, state-owned enterprises (SOEs) impose economic and social costs in terms of foregone growth, inefficient practices, draining resources that could be used for social expenditure, and adding cost to the private sector through the inefficient provision of outputs. However, the study also demonstrates that improvement is possible.

Worldwide, privatization—supported by robust regulatory arrangements—has led to long-term improvements in the productivity of formerly owned state assets. Transitioning state assets to private control should remain the underlying goal for the countries participating in this study.

Importantly, the performance of SOEs that remain under government control will only be improved by placing them on a fully commercial footing. This requires strong political commitment to require commercial rates of return from SOEs, give them the independence to achieve these returns, and hold them accountable for results.

SOE legal, governance, and monitoring frameworks can support the achievement of commercial results if fully implemented. Countries participating in this study all have elements of best practice legislation, governance rules, and/or monitoring structures, implemented with varying degrees of success. These provide valuable guidance and lessons for governments which are seeking to improve SOE performance.

- **SOE legislation.** Pacific islands countries have been at the leading edge of best practice SOE legislation, and this continues with the adoption of the SOE Act in Marshall Islands in 2015. The new SOE Act requires SOEs to be profitable and maximize shareholder value while also introducing a mandatory code of conduct. The draft Vanuatu SOE bill requires SOEs to achieve a ROE that covers their cost of capital. The SOE acts in the Marshall Islands, Samoa, Solomon Islands, and Tonga represent a good balance between effective state oversight and the commercial independence of the SOE board. The laws require SOE boards to generate profits comparable with private sector firms, while the state's oversight is structured and transparent. Comprehensive community service obligation (CSO) provisions reinforce the SOE's commercial mandate and provide a legitimate and nondistortionary means for the state to purchase social outcomes from SOEs. Implementation of certain provisions of the SOE Acts remain challenging in all countries, in particular the CSO provisions and commercial mandate of SOEs in Samoa.

- **Governance rules.** The governance rules in a number of the benchmarked countries reflect global best practice. The SOE regulations in Solomon Islands contain a skills-based director selection and appointment process specifying that only the best-qualified candidate can be appointed to fill a vacancy. The Independent Selection Committee in Samoa comprises three private sector members who are responsible for the director selection process up to the point of identifying the preferred short-list candidates: Cabinet can only appoint from the Independent Selection Committee's short list. Tonga has adopted a similar process and has developed the concept of shared directors, where one or more directors are appointed to SOE boards that operate in similar sectors. This is designed to spread good practice among the SOEs, encourage shared services to reduce cost, and encourage efficiencies, and to address the perceived shortage of competent SOE directors. The governance codes adopted in Jamaica and Mauritius are comprehensive and contain guidelines on board composition—diversity and gender—and codes of ethics and social responsibility. SOEs in Mauritius must report the implementation of the code in their annual reports. The Jamaican code, when approved by cabinet, will be adopted through regulations. The Marshall Islands SOE Act contains provisions dealing with conflict of interest and a code of ethics for directors and staff.

In Fiji, the Marshall Islands, Samoa, Solomon Islands, and Tonga, ministers are restricted[126] by law from sitting on SOE boards, essential to reduce politicization of SOEs. Jamaica's corporate governance code goes further by prohibiting permanent secretaries from serving on SOE boards, although the requirement is not enforced. As is the case with legislation, implementation of governance rules remains challenging, but the dramatic strengthening of the SOE boards in Samoa, Solomon Islands, and Tonga since 2010 demonstrates what is achievable.

- **Monitoring.** The international trend towards centralized ownership monitoring is reflected in recent

126 Ministers cannot be appointed to SOE boards in Fiji. In Samoa, Solomon Islands, and Tonga, ministers can only be appointed under very limited circumstances and, in the case of Tonga, for no more than 12 months.

developments in the Pacific. In 2015, Samoa created a Ministry of Public Enterprises with a dedicated SOE minister to join Tonga as the second Pacific island country to boast of a centralized SOE monitor, independent from the Ministry of Finance and sector ministries. In the Marshall Islands, while there is a single minister responsible for all SOEs, the monitoring unit is structured as a division within the Ministry of Finance. The Vanuatu SOE Bill defines the role of the monitoring unit to ensure that, while it sits within the Ministry of Finance and Economic Management, it has a direct reporting line to the SOE minister. Papua New Guinea (PNG) and Singapore have adopted a SOE holding company model. PNG's model, the Kumul Consolidated Holdings, is not considered good practice (Box 8), while Singapore's Temasek Holdings has some good practice attributes, such as governance and reporting, but functions more as a sovereign wealth fund than a SOE holding company.

- **Transparency.** Transparency and accountability can change behavior. Solomon Islands, the Marshall Islands, and Tonga require SOEs to publish copies or summaries of their planning documents and annual reports in local newspapers. Vanuatu's SOE Bill contains a similar provision. In practice, only Tonga is doing this systematically. The requirement in Samoa, the Marshall Islands, Solomon Islands, and Tonga for the responsible minister to negotiate statements of corporate intent with SOE boards provides a good practice mechanism for the state as owner to influence direction, and to hold boards to account, without undermining the SOE's commercial independence. This balance is effectively achieved in the legislation in the Marshall Islands, Tonga, and Solomon Islands, where responsible ministers can influence, but cannot direct the content of these plans. A similar requirement, although less well-defined, is found in the Jamaican SOE Act.[127] Mauritius is adopting a similar practice through the use of performance contracts.

Recognizing that SOEs are not a sustainable service delivery model, Jamaica has developed a privatization policy and Fiji, Mauritius, and PNG have public–private partnership (PPP) laws. Samoa and Tonga adopted new SOE ownership and divestment policies in 2015, establishing the default principle that the state should exit from its SOEs. The policies also included privatization pipelines. Kiribati has utilized a privatization decision tree to identify SOEs that the state should no longer own, and those identified have either been sold or liquidated. These policies and laws are designed to facilitate greater private sector participation in the SOEs and the services they provide, and are fully compatible with governments' commitments to deliver CSOs. Indeed, these policies and laws encourage greater efficiencies in CSO delivery by encouraging competitive provision by the private sector.

- **Privatization policies adopted in Kiribati, Samoa, and Tonga are predicated on the principle that the state should divest SOEs that are engaged in competitive activities.** Jamaica's privatization policy represents good international practice. It requires postprivatization audits in the case of partial divestments, to ensure what was expected eventuates, and to provide a useful feedback loop for future privatizations. Jamaica is the only country with a formalized privatization transaction guideline, and its policy requires the government to disclose how it will use any privatization proceeds. The Development Band of Jamaica appears to have effectively implemented the policy since it was put in charge of the program in 2006.
- **PNG adopted its PPP law in September 2014 and full implementation is expected in 2016.** In Fiji, the government has determined that its 2006 PPP law will inhibit successful implementation of PPPs and intends to develop a new legislative framework. In Mauritius, the PPP law has been in place since 2004, but the absence of effective institutional arrangements has constrained its implementation. Even in the absence of formal PPP policies and laws, Pacific countries continue to structure simple PPP transactions. Performance-based service contracts for subsidized shipping services are in place in Fiji, Solomon Islands, and PNG; Tonga's water SOE has contracted out pipe maintenance; and Kiribati's state-owned hotel is managed through a PPP while a PPP for the shipway is expected to be complete in early 2016. In September 2015, the power SOE in the Marshall Islands announced the instillation of a waste-heat-to-power generation unit procured through a PPP. In Vanuatu, power generation and distribution have been contracted to the private sector since 1939. Sound procurement rules, modern contracting law, and cost effective dispute mechanisms can provide a sufficient legal framework for PPP transactions in smaller economies. For those economies looking to prepare a pipeline of PPP transactions, a formal PPP law is essential to creating transparency, predictability, and efficiency in the process, thereby reducing investor risk and transaction costs.

[127] Section 7, Public Bodies Management and Accountability Act 2011.

An effective and well-functioning competition framework is important in promoting the efficient operation of SOEs. Ensuring that SOEs cannot misuse their market power, that they are required to invest in order to protect their commercial position, that they are required to improve their productivity, and that they cannot receive undue favors from the government will be a powerful tool in promoting more efficient operation. The introduction of effective competition frameworks is beginning in the Pacific region, Samoa being the first. Other countries are also realizing the benefits of competition law, so the extent to which these are used will grow over the next few years.

The experience of the 10 countries participating in this study demonstrates that commercial returns from SOEs are only achievable with strong political commitment to implement a robust legal, monitoring, and governance framework. Politicians must diligently enforce the requirements of the underlying SOE legislation, resist the temptation to directly interfere in the business of the SOEs, and allow greater private sector participation in delivering goods and services traditionally provided by SOEs. But experience also shows that sustained reform commitment is challenging, if not impossible. Private sector participation and privatization are the best mechanisms to lock in the gains from commercialization.

Appendix 1

STATE-OWNED ENTERPRISE PERFORMANCE INDICATORS, FY2014

Table A1.1. Fiji State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (F$ '000)	Total Revenue (F$ '000)	Asset Utilization (%)	Total Liabilities (F$ '000)	Average Return on Assets FY2002–FY2014 (%)
PRB	Public Rental Board	100	2	1	30,619	2,953	10	13,828	11
HA	Housing Authority	100	2	1	184,658	18,910	10	130,457	1
UTOFML	Unit Trust of Fiji (Management) Limited[a]	100	NA	NA	NA	NA	NA	NA	7
FPFL	Food Processors (Fiji) Limited	100	4	2	9,113	3,296	36	5,379	1
RRL	Rewa Rice Limited	100	NA	NA	NA	613	NA	NA	(7)
VCCL	Viti Corps Company Limited	100	NA	NA	NA	NA	NA	NA	NA
YPCL	Yaqara Pastoral Company Limited	100	28	23	10,367	3,905	38	1,854	11
FPTCL	Fiji Public Trustee Corporation Limited	100	7	7	9,540	1,467	15	26	4
FP	Fiji Pine[b]	100	NA	NA	NA	NA	NA	NA	(3)
PAFCO	Pacific Fishing Company Limited	100	3	1	32,826	28,071	86	14,930	2
FHCL	Fiji Hardwood Corporation Limited[a]	90	NA	NA	NA	NA	NA	NA	(1)
AirPac	Fiji Airlines	51	24	5	563,182	394,101	70	452,636	2
FSC	Fiji Sugar Corporation	68	NE	1	189,906	152,635	80	248,152	(14)
FEA	Fiji Electricity Authority	100	0	0	1,120,527	307,804	27	519,878	1
PFL	Post Fiji Limited	100	8	3	37,455	30,196	81	24,223	1
FPCL	Fiji Ports Corporation	100	7	6	126,756	38,202	30	20,674	3
AFL	Airports Fiji Limited	100	8	7	206,809	64,366	31	33,750	3
FBCL	Fiji Broadcasting Corporation Limited	100	NE	(20)	19,316	9,313	48	20,674	(4)
ATS	Air Terminal Services	51	7	6	19,032	17,674	93	3,755	8
FDB	Fiji Development Bank	100	4	1	335,117	32,352	10	208,618	1
Portfolio			**5.0**	**2.1**	**2,895,224**	**1,105,859**		**1,700,803**	**0.9**

F$ = Fiji dollar, FY = financial year, ( ) = negative, NA = not available, NE = negative equity, ROA = return on assets.

[a] Average ROA from FY2002–FY2013.

[b] Average ROA from FY2002–FY2011.

Source: Government of Fiji, Ministry of Public Enterprises.

Table A1.2. Jamaica: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (JMD '000)	Total Revenue (JMD '000)	Asset Utilization (%)	Total Liabilities (JMD '000)	Average Return on Assets FY2002–FY2014 (%)
JUTC	Jamaica Urban Transit Corp	100	(17)	(7)	12,935	5,502	43	7,615	(272)
DBJ	Development Bank of Jamaica	100	11	4	23,269	2,310	10	14,801	1
PetroJAM	Petroleum Jamaica	100	(3)	(1)	62,670	197,822	316	48,479	5
PCJ	Petroleum Corporation of Jamaica	100	16	15	13,076	2,874	22	1,242	6
NWC	National Water Commission	100	(136)	(9)	76,038	24,933	33	70,904	(5)
AAJ	Airports Authority Jamaica	100	8	2	20,528	4,537	22	14,843	1
CTL	Caymanas Track Limited	100	NE	(8)	499	4,643	930	989	(6)
NEIBJ	National Export-Import Bank of Jamaica Ltd.	100	3	1	8,160	728	9	5,785	1
FCJ	Factories Corporation of Jamaica	100	14	14	8,737	1,630	19	522	4
HAJ	Housing Agency of Jamaica Limited	100	(32)	(4)	14,025	457	3	12,121	(2)
PAJ	Ports Authority of Jamaica	100	7	1	54,932	19,012	35	43,668	4
JMB	Jamaica Mortgage Bank	100	(6)	(3)	2,786	202	7	1,268	0
PSC	Ports Security Corps Ltd.	100	NE	(29)	87	585	670	332	(23)
JBM	Jamaica Bauxite Mining Ltd.	100	NE	22	5,732	3,762	66	6,125	(2)
UDC	Urban Development Corporation	100	1	1	45,079	2,543	6	4,163	7
BATCO	Bauxite and Alumina Trading Community Ltd.	100	NA	NA	NA	NA	NA	NA	6
SCJ	Sugar Company of Jamaica	100	NA	NA	NA	NA	NA	NA	NA
NROCC	National Road Operating and Constructing Company Ltd.	100	NE	(34)	22,036	2,488	11	65,881	(13)
CAP	Clarendon Alumina Production Ltd.	100	(84)	(28)	32,876	17,236	52	21,727	(9)
Portfolio			**(22.9)**	**(4.7)**	**403,465**	**291,265**		**320,464**	**(2.8)**

FY = financial year, JMD = Jamaican dollar, ( ) = negative, NA = not available, NE = negative equity
Source: Government of Jamaica, Public Enterprise Division, Ministry of Finance and Planning.

Table A1.3. Kiribati: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (A$ '000)	Total Revenue (A$ '000)	Asset Utilization (%)	Total Liabilities (A$ '000)	Average Return on Assets FY2008–FY2014 (%)
AK	Air Kiribati	100	(20)	(7)	12,637	3,431	27	7,945	7
BPA	Broadcasting & Publications Authority	100	12	9	1,283	1,136	89	347	(4)
CPP	Central Pacific Producers[a]	100	NA	NA	NA	NA	NA	NA	(1)
DBK	Development Bank of Kiribati	100	3	2	9,644	1,230	13	4,101	1
KCCS	Kiribati Copra Cooperative Society	100	55	20	2,260	2,887	128	1,441	(7)
KCM	Kiribati Copra Mill	100	38	33	2,603	1,604	62	340	(7)
KHC	Kiribati Housing Corporation	100	(10)	(9)	6,738	1,696	25	881	0
KIC	Kiribati Insurance Corporation	100	3	3	6,483	1,518	23	278	2
KOC	Kiribati Oil Co	100	0	0	20	35	175	9	2
KPA	Kiribati Ports Authority	100	3	3	69,877	9,935	14	740	5
KSS	Kiribati Shipping Services[b]	100	(176)	(39)	1,119	1,155	103	872	0
KSE	Kiribati Solar Energy[c]	100	30	23	1,238	568	46	274	2
PVU	Plant & Vehicle Unit	100	22	19	8,379	3,651	44	915	9
PUB	Public Utilities Board	100	1	0	29,785	12,446	42	13,293	4
TAAM	Te Atonimarawa Aggregate Mining[d]	100	(9)	(9)	2,791	123	4	(35)	(3)
TSK	Telecom Services Kiribati	100	9	4	19,234	6,872	36	10,948	7
BS	Betio Shipyards	100	106	30	1,707	957	56	1,218	10
Portfolio			**3.9**	**2.9**	**175,798**	**49,245**		**43,566**	**2.3**

( ) = negative, A$ = Australian dollar, FY = financial year, () = negative, NA = not available, ROA = return on assets.

[a] Average ROA from FY2008–FY2013.
[b] Average ROA from FY2012–FY2014.
[c] Average ROA from FY2009–FY2014.
[d] Average ROA from FY2013–FY2014.

Source: Government of Kiribati, SOE Monitoring and Advisory Unit, Ministry of Finance and Economic Development.

Table A1.4. The Marshall Islands: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets ($ '000)	Total Revenue ($ '000)	Asset Utilization (%)	Total Liabilities ($ '000)	Average Return on Assets FY2002–FY2014 (%)
Kajur	Kwajalein Atoll Joint Utility Resources	100	(71)	(15)	3,791	6,541	173	2,968	(34)
MEC	Marshalls Energy Company	100	NE	1	22,931	51,919	226	26,870	(5)
NTA	National Telecommunication Authority	76.4	(28)	(3)	33,609	8,350	25	29,565	0
MIPA	Marshall Islands Ports Authority	100	(3)	(3)	66,869	4,270	6	3,780	(2)
MIDB	Marshall Islands Development Bank	100	11	8	24,709	4,616	19	7,211	3
MWSC	Majuro Water and Sewer Company	100	(154)	(24)	2,046	1,158	57	1,733	2
MRI	Majuro Resort[a]	100	NA	NA	NA	NA	NA	NA	(35)
Tobolar	Tobolar Copra Processing Plant	100	(164)	(37)	2,530	11	0	1,964	(16)
AMI	Air Marshall Islands	100	NE	(7)	7,579	2,988	39	8,635	(20)
MAWC	Majuro Atoll Waste Corporation	100	(68)	(48)	894	456	51	266	(9)
MISC	Marshall Islands Shipping Corporation	100	40	13	693	2,958	427	468	(5)
Portfolio			**(4.5)**	**(2.2)**	**165,651**	**83,266**		**83,459**	**(5.0)**

FY = financial year, $ = US dollar, ( ) = negative, NA = not available, NE = negative equity, ROA = return on assets

[a] Average ROA from FY2002–FY2012.

Source: Government of the Marshall Islands annual economic statistics tables and annual SOE audit reports.

Table A1.5. Mauritius: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (MUR '000)	Total Revenue (MUR '000)	Asset Utilization (%)	Total Liabilities (MUR '000)	Average Return on Assets FY2002–FY2014 (%)
STC	State Trading Corporation	100	26	6	6,503	32,856	505	4,922	1
CEB	Central Electricity Board	100	11	6	27,032	14,757	55	11,747	1
CWA	Central Water Authority	100	6	3	9,230	1,769	19	4,951	0
WWMA	Waste Water Management Authority	100	NE	(5)	2,280	427	19	2,466	4
AML	Airports of Mauritius	100	3	1	18,339	1,564	9	10,945	9
NHDC	National Housing Development Company Limited	100	0	0	1,140	158	14	635	1
DBM	Development Bank of Mauritius	100	(27)	(6)	7,217	509	7	5,721	0
MHC	Mauritius Housing Corp	100	7	3	7,050	419	6	4,432	3
SLDC	State Land Development Company	100	(2)	(1)	2,378	115	5	270	0
NTC	National Transport Corporation	100	NE	(9)	845	1,277	151	1,528	(2)
MPA	Mauritius Ports Authority	100	3	3	22,369	1,437	6	1,552	7
BPM	Business Parks Mauritius	100	1	1	4,114	142	3	703	3
RBSEB	Rose Belle Sugar Estate Board[a]	100	NA	NA	NA	NA	NA	NA	0
AMB	Agricultural Marketing Board	100	22	11	485	598	123	247	5
SIL	State Informatics	100	9	5	314	392	125	126	2
RDA	Road Development Authority	100	(3)	(1)	603	198	33	768	0
MSC	Mauritius Shipping Corporation[b]	100	NA	NA	NA	NA	NA	NA	(4)
MFDC	Mauritius Film Development Corporation	100	4	3	10	11	110	2	(3)
EM	Enterprise Mauritius	100	(16)	(7)	110	213	193	61	(1)
AIR	Air Mauritius	59	11	2	8,315	11,470	138	6,338	(1)
Portfolio			**5.0**	**2.6**	**118,336**	**68,312**		**57,413**	**1.9**

FY = financial year, MUR = Mauritian rupee, ( ) = negative, NA = not available, NE = negative equity, ROA = return on assets.

Source: Government of Mauritius, Office of Public Sector Governance.

Table A1.6. Papua New Guinea: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (K '000)	Total Revenue (K '000)	Asset Utilization (%)	Total Liabilities (K '000)	Average Return on Assets FY2002–FY2014 (%)
TPNG	Telikom PNG Limited	100	(2)	(1)	1,167,857	318,870	27	458,302	5
PPL	PNG Power Limited	100	7	4	1,639,239	912,839	56	837,963	3
PPCL	PNG Ports Corporation	100	6	4	1,412,425	246,794	17	505,207	4
PPNG	Post PNG Limited	100	4	3	177,391	52,338	30	28,582	(5)
PNGWB	PNG Water Board	100	12	5	289,074	83,473	29	165,325	1
ANL	Air Niugini Limited	100	0	0	909,137	1,205,869	133	442,315	4
ERL	Eda Ranu Limited	100	4	3	132,504	118,163	89	25,876	4
NDB	National Development Bank	100	2	1	582,387	46,095	8	73,202	(10)
BMOB	B Mobile	85	(148)	(15)	231,444	31,207	13	207,278	(3)
Portfolio			**2.4**	**1.4**	**6,541,458**	**3,015,648**		**2,744,049**	**2.9**

FY = financial year, ( ) = negative, K = kina, PNG = Papua New Guinea.

Source: Kumul Consolidated Holdings.

Table A1.7. Samoa: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (ST '000)	Total Revenue (ST '000)	Asset Utilization (%)	Total Liabilities (ST '000)	Average Return on Assets FY2002–FY2014 (%)
EPC	Electric Power Corporation	100	0	0	414,750	119,758	29	207,294	1
SWA	Samoa Water Authority	100	(3)	(2)	137,482	24,123	18	70,567	(3)
SAA	Samoa Airport Authority	100	1	1	58,939	13,279	23	3,181	(1)
SPA	Samoa Ports Authority	100	0	0	222,210	16,050	7	80,311	0
SSC	Samoa Shipping Corporation Limited	100	8	2	82,610	23,441	28	60.719	5
DBS	Development Bank of Samoa	100	(9)	(2)	183,834	5,343	3	133,751	(1)
SHC	Samoa Housing Corporation	100	3	2	41,279	4,512	11	14,293	2
ASC	Agricultural Stores Corporation	100	(24)	(18)	5,494	4,005	73	1,328	0
PTO	Public Trust Office	100	6	3	7,132	1,193	17	3,533	(16)
SLC	Samoa Land Corporation	100	0	0	122,122	8,985	7	68,328	0
STEC	Samoa Trust Estates Corporation	100	(3)	(3)	48,322	389	1	5,891	0
SSS	Samoa Shipping Services Limited[a]	100	NA	NA	NA	NA	NA	NA	0
PAL	Polynesian Airlines Limited	100	8	6	32,385	15,455	48	9,779	(7)
SAMPOS	Samoa Post	100	20	5	7,594	2,182	29	5,683	4
UTOS	Unit Trust of Samoa	100	56	53	1,770	1,569	89	96	(22)
Portfolio			**(0.6)**	**(0.3)**	**1,365,924**	**240,283**		**664,573**	**(0.04)**

FY = financial year, ( ) = negative, NA = not available, ROA = return on assets, ST = tala.

[a] Average ROA from FY2002–FY2012.

Source: Government of Samoa, State-Owned Enterprise Monitoring Unit, Ministry of Finance.

Table A1.8. Solomon Islands: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (SI$ '000)	Total Revenue (SI$ '000)	Asset Utilization (%)	Total Liabilities (SI$ '000)	Average Return on Assets FY2002–FY2014 (%)
SAL	Solomon Airlines Limited	100	(21)	(5)	175,371	257,660	147	135,051	(4)
SIPC	Solomon Islands Postal Corporation[a]	100	NE	(2)	27,195	12,097	44	79,158	(34)
SIBC	Solomon Islands Broadcasting Authority	100	12	10	18,911	10,489	55	4,015	(18)
SIEA	Solomon Islands Electricity Authority	100	14	13	720.757	463,955	64	58,173	3
SIPA	Solomon Islands Port Authority	100	3	3	408,382	106,667	26	16,825	4
SIWA	Solomon Islands Water Authority[a]	100	15	3	199,497	93,184	47	160,102	(12)
Portfolio			**9.2**	**6.5**	**1,550,112**	**944,053**		**453,324**	**(0.1)**

FY = financial year, ROA = return on assets, SI$ = Solomon Islands dollar.

[a] Average ROA from FY2005–FY2014.

Source: Government of Solomon Islands, Ministry of Finance and Treasury.

Table A1.9. Tonga: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (T$ '000)	Total Revenue (T$ '000)	Asset Utilization (%)	Total Liabilities (T$ '000)	Average Return on Assets FY2002–FY2014 (%)
Tpower	Tonga Power Limited[a]	100	14	8	94,335	59,648	63	38,503	5
TFPL	Tonga Forest Products Limited	100	(3)	(1)	9,248	2,868	31	5,740	0
TML	Tongatapu Markets Limited	100	7	3	3,583	1,026	29	2,007	2
FISA	Friendly Island Shipping Agency[b]	100	38	9	4,517	6,654	147	3,406	21
TDB	Tonga Development Bank	100	10	2	85,140	7,842	9	64,852	3
TBC	Tonga Broadcasting Commission	100	0	0	3,904	2,087	63	1,456	(2)
TCC	Tonga Communications Corporation	100	4	3	73,118	24,677	33	27,143	5
PAT	Ports Authority Tonga	100	7	5	22,785	8,184	36	5,776	3
TWB	Tonga Water Board	100	6	6	17,903	7,060	39	1,885	2
WAL	Waste Authority Limited[c]	100	NE	0	3,123	1,794	57	3,184	(9)
TAL	Tonga Airports Limited[d]	100	4	4	37,164	9,254	25	3,003	(1)
Tpost	Tonga Post Limited[a]	100	(1)	(1)	3,964	504	13	645	(2)
TAMA	Tonga Assets Managers and Associates Limited[b]	100	(2)	(2)	9,317	498	5	1,894	(2)
TCL	Tonga Cable Limited[e]	87	0	0	44,573	3,491	8	447	0
Portfolio			**6.0**	**3.7**	**412,674**	**135,588**		**159,941**	**3.3**

FY = financial year, ( ) = negative, ROA = return on assets, T$ = pa'anga.

[a] Average ROA from FY2009–FY2014.
[b] Average ROA from FY2012–FY2014.
[c] Average ROA from FY2007–FY2014.
[d] Average ROA from FY2008–FY2014.
[e] Average ROA from FY2013–FY2014.

Source: Government of Tonga, Ministry of Public Enterprises.

Table A1.10. Vanuatu: State-Owned Enterprise Performance Indicators, FY2014

State-Owned Enterprise		Ownership (%)	Return on Equity (%)	Return on Assets (%)	Total Assets (Vt '000)	Total Revenue (Vt '000)	Asset Utilization (%)	Total Liabilities (Vt '000)	Average Return on Assets FY2008–FY2014 (%)
AV	Airports Vanuatu	100	1	1	4,436,314	737,379	17	1,143,436	1
AIRV	Air Vanuatu	100	NE	(18)	4,755,375	5,139,318	108	5,392,283	(13)
NBV	National Bank of Vanuatu	100	5	1	10,158,283	991,919	10	9,040,457	1
VADB	Vanuatu Agriculture Development Bank	100	1	1	449.657	138,197	31	51,827	(5)
VBTC	Vanuatu Broadcasting & Television Corp[a]	100	(3)	(2)	371,714	133,634	36	83,435	1
VPOST	Vanuatu Post[b]	100	NA	NA	NA	NA	NA	NA	11
NHC	National Housing Corporation[c]	100	NA	NA	NA	NA	NA	NA	(13)
Portfolio			**(16.8)**	**(3.7)**	**20,171,343**	**7,140,448**		**15,711,437**	**(1.3)**

FY = financial year, ( ) = negative, NA = not available, NE = negative equity, ROA = return on assets, Vt = vatu.

[a] Average ROA from FY2010–FY2014.
[b] Average ROA from FY2008–FY2013.
[c] Average ROA from FY2009–FY2013.

Source: Government of Vanuatu, Department of Finance and Treasury.

Appendix 2

SUMMARY OF STATE-OWNED ENTERPRISE REFORM INDICATORS

SOE Reform Indicators	FIJ	JAM	KIR	RMI[a]	MUS	NZL	PNG	SAM	SOL	TON	VAN
Legislation											
Comprehensive SOE legal framework[b]											
Commercial mandate[c]	2		1		2	3	1	1	2	3	0
Community Service Obligation provisions and guidelines											
SOE legal framework implemented[d]	(2)		3			(3)	(2)	(7)	3	4	0
Monitoring											
Responsible minister											
Responsible minister separate to sector/line minister											
Effective ownership monitor[e]	3	2	3	1	2	4	3	3	3	4	2
SOEs operate within tight budget constraints[f]	3	1	3	1	1	4	1	1	3	2	1
Requirement for statement of corporate intent and/or business plan											
Profit target such as return on equity implemented											
Governance											
Skills-based director selection and appointment process operating											
Elected officials cannot serve on SOE boards											
Civil servants cannot serve on SOE boards											
Civil servants appointed to SOE boards on restricted basis											
Audited annual reports generally submitted on time											
Good governance principles enforced											
Political commitment to reform[g]	1	3	3	2	2	2	1	2	2	3	2
Total Score	**22**	**14**	**31**	**5**	**22**	**44**	**18**	**27**	**37**	**52**	**5**
Average return on assets, 2010–2014 (%)	1.5	(2.3)	2.8	(3.7)	3.4	(0.4)	1.3	(0.4)	6.7	2.6	(0.0)

( ) = negative, FIJ = Fiji, JAM = Jamaica, KIR = Kiribati, MUS = Mauritius, NZL = New Zealand, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, SAM = Samoa, SOE = state-owned enterprise, SOL = Solomon Islands, TON = Tonga, VAN = Vanuatu.

Notes:
1. When a cell is blue, indicator is true. For scoring, blue = 3, blank = 0.
2. Determined by interview, questionnaires completed by participating country counterparts and observation. Scale of 1–5: 1 = weak, 5 = strong level of commitment.

[a] RMI adopted a comprehensive SOE Act in December 2015. As the survey covers 2010–2014, the SOE Act has been taken into account for this table.
[b] Combination of legislation (including Companies Act for SOE registered as companies), regulations, and codes of conduct that together are at least as comprehensive as the New Zealand SOE Act.
[c] Scale of 1–5: 0 = not evident, 5 = stipulated in SOE legal framework for all SOEs, Companies Act, and/or regulatory contracts and implemented.
[d] Scale of 1–5: -11 = weak implementation, 0 = partial implementation, 5 = substantial implementation.
[e] Scale of 1–5: 1 = not evident, 3 = some evidence of ownership monitoring, 5 = effective monitoring.
[f] Average government transfers 2010–2014 as a percentage of SOE portfolio total assets. Low or positive percentage = tight budget constraints. Scale 1 = poor budget constraints, 3 = medium-level budget constraints, 5 = high budget constraints.
[g] Whether submitted within statutory deadlines. Determined by interview and survey. 1= generally not submitted on time, 5 = generally submitted on time.

Sources: Annual reports; participating country surveys; Pacific Private Sector Development Initiative analysis.

Appendix 3

OVERVIEW OF STATE-OWNED ENTERPRISE LEGAL, GOVERNANCE, AND MONITORING REFORMS, 2005–2014

Issue	Country	Nature of Reform
Ownership policy and monitoring	Africa	SOE Network for Southern Africa formed in 2007 to support regional and national reform
	Bhutan	Established Druk Holding & Investments as SOE holding company (2007)
	Chile	Measures adopted to protect SOEs from receiving instructions from the government and eliminate preferential treatment for SOEs
	People's Republic of China	SOE Act (2013), development of SOE holding companies (2015)
	Colombia	Adopted more centralized and strengthened SOE ownership monitoring in 2010
	Finland	State-Ownership Act (2007) outlining key principles and operating practices of the state's ownership function
	Kiribati	Kiribati SOE Act (2012), established central ownership monitor,
	Kuwait	Privatization Commission established in 2012
	Marshall Islands	Marshall Islands SOE Act 2015, establishes central ownership function
	Namibia	SOE Act (2006)
	Norway	Official government ownership policy for SOEs published in 2007
	Pakistan	Broad-based SOE reform and privatization program launched 2011[a]
	Paraguay	Developed performance management contracts (Statement of Corporate Intent) for SOEs in 2009–2010, with quarterly performance reports; monitoring agency's strategic plan published on website
	Poland	Draft legislation identifies companies of key importance
	Portugal	Council of Minister's best practice for public companies to increase transparency and encourage improved governance practices (2007)
	Samoa	Samoa SOE Act strengthened in 2015 and SOE minister appointed and ministry established; SOE ownership and divestment policies adopted in 2015
	Spain	Ownership policy for SOEs establishes guidelines for commercial and noncommercial objectives, outline of the role of shareholding minister, and good practices for SOEs including increased transparency – General Rules on the Assets of the Central Government (2009)
	South Africa	South Africa SOE ownership policy developed by the President's SOE Review Committee
	Switzerland	Guidelines for SOE governance – Corporate Governance Report (2006)
	Tonga	SOE ownership and divestment policies adopted in 2014
	Uruguay	All SOEs must produce accounts in accordance with the 2003 version of International Financial Reporting Standards
	Viet Nam	State Capital Investment Corporation established as a SOE holding company in 2005 to own equitized SOEs
Categorization of public institutions	Estonia	Legislation forbids SOE boards from taking instructions from government. Business plans are approved through the annual general meeting
	Republic of Korea	Public Institution Management Act (2007) covers public institutions that are commercial, noncommercial or quasi-government. To be an SOE, the entity must be more than 50% owned by the state and generate at least 50% of its own revenue and, if 85%, will be classified as a commercial SOE.
	Poland	Bill before Parliament will bring management of SOEs under one act. SOE activity will be drawn closer to private sector firms, and noncommercialized SOEs will be eliminated.

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Table *continued*

Issue	Country	Nature of Reform
Governance	Australia	Commonwealth Government Business Enterprises – Governance and Oversight Guidelines issued in October 2011
	Colombia	2005 Securities Market Law established mandatory governance practices for issuing entities, including partially listed SOEs
	Czech Republic, Finland, Norway, and Sweden.	Guidelines for the remuneration and employment conditions of SOE managers implemented in the respective jurisdictions.
	Germany, Italy, Spain, and Switzerland	Introduced rules to enhance the integrity of SOE directors, including provisions regarding conflicts of interest and professional qualifications
	Republic of Korea	The chair of a commercial SOE must always be an outside director.
	Peru	El Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE),[b] the SOE holding company, approved the Good Governance Code, Code of Ethics, and Code of Internal Control (2006). In 2010, FONAFE established a requirement that at least one SOE director must be selected by a private search firm.
	Poland	Rules being defined to guide the selection and composition of SOE boards with the creation of a state nomination committee
	Portugal	Strategic guidelines have been issued for use of management objectives
	General	Organisation for Economic Co-operation and Development (OECD) reports that most of the recent changes concerning board composition and qualification have the effect of limiting the scope for politicization and the use of SOE boards for patronage. OECD updated its Corporate Governance Guidelines for SOEs in 2015.
Transparency and disclosure	Chile	Transparency Act (2009) requires all SOEs to provide the same information and comply with same accounting standards as private firms.
	Germany	Parliamentary committee established in 2009 to oversee the management of SOEs.
	Switzerland	Comprehensive report on the performance of all SOEs commenced in 2011
	Finland, France, Ireland, New Zealand, Norway, and Turkey	Countries publish comprehensive reports on the performance of all SOEs, including aggregate portfolio information and specific SOE performance. Reports also disclose key ownership and governance policies that apply to the SOEs.
	Italy	Procedures must be public, transparent, and impartial for SOEs' hiring of staff and purchasing external advice.
	Republic of Korea	Online system introduced in 2005 to provide real time information on the financial and nonfinancial performance of all SOEs
	Middle East and North Africa[c]	Progressive implementation of competition authorities to ensure SOEs compete on level playing field with the private sector; increased focus on transparency and accountability; and Abu Dhabi Accountability Authority established in 2008
	New Zealand	Continuous disclosure regime implemented in 2010 for the seven largest SOEs
	Poland	Draft legislation to increase transparency on the operation of SOEs
	Sweden	Guidelines for external reporting provide that SOEs should be as transparent as listed companies. Guidelines are based on "comply or explain" 2007.
	Turkey	Council of Minister's Decree in 2006 directed all SOEs to publish annual accounts and include information on websites.

SOE = state-owned enterprise.

[a] J. Speakman. 2012. SOE Reform: Time for Serious Corporate Governance. World Bank Policy Paper Series on Pakistan. No. PK 04/12. Washington, DC.
[b] National Fund for Financing State Business Activity
[c] OECD. 2013. *State-owned Enterprises in the Middle East and North Africa – Engines of Development and Competition*. Paris.

Source: Adapted from OECD. 2011. *Corporate Governance of State-Owned Enterprises: Change and Reform in OECD Countries Since 2005*. Paris. http://dx.doi.org/10.1787/9789264119529-en

Appendix 4

CONTENT OF STATE-OWNED ENTERPRISE LEGISLATION IN SURVEY COUNTRIES, FY2014

Issue	TON	SAM	FIJ	SOL	PNG	NZL	JAM	MUS	KIR	RMI
Legislation and topics covered	Public Enterprise Act 2002 and 2010 Amendment	Public Bodies Act 2001 (amended in 2015) Regulations and Composition Act 2012	Public Enterprise Act 1996	SOE Act 2007 and Regulations	IPBC Act 2002 as amended 2012 and 2015	SOE Act 1986 and Companies Act[a] NZ Treasury Guidelines[b]	Public Bodies Management and Accountability Act 2003 as amended, Financial Administration and Audit Regulations 2015 and Code of Conduct for Directors[c]	Statutory Bodies (Accounts and Audit) Act 1972; Financial Reporting Act 2004; National Code of Corporate Governance 2004[d]	SOE Act 2012	SOE Act 2015
Establishment of SOEs	Sections 7 and 8	Sections 5 and 6	Sections 6–30 and schedules			Sections 10–12 and 23–32		Establishing Act or Companies Act	Sections 34 and 35	Sections 5–6
Principal objective of SOEs	Section 4	Section 8 and 14	Section 43 and KP1	Section 5		Section 4		Section 2 Code of Corporate Governance – Corporate Objective Statement	Section 5	Section 10
Sale of shares or privatization of SOE		Section 7			Section 9				Sections 7 and 8	Sections 7(c) and 8
Governance										
Appointment process for directors	Sections 12 and 14	Section 15, Regulations and Composition Act	Sections 31 and 56	Sections 6 (Subsections 1–3) and Regulations	Sections 11 and 12	Section 5 and Treasury Guidelines	Code of Conduct	Section 2 Code of Corporate Governance	Section 17	Sections 18 and 22
- Number of directors	Section 12	Composition Act			Section 12			Entity-specific legislation/ Companies Act		Section 17
- Remuneration of directors	Section 12(2)				Sections 20 and 46I	Treasury Guidelines		Section 2.8 Code of Corporate Governance		Section 22

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Table *continued*

Issue	TON	SAM	FIJ	SOL	PNG	NZL	JAM	MUS	KIR	RMI
- Attributes for selection	Section 14(1)	Regulations (Schedule 3)		Section 6 and Regulations	Section 12	Treasury Guidelines	Code of Conduct	Section 2.2 Code of Corporate Governance	Section 17(1)	Section 18(2)
Appointment process for chairs		Composition Act			Section 12(11)	Treasury Guidelines		Section 2.5 Code of Corporate Governance		Section 18(5)
Composition of the board	Section 12(1)	Composition Act		Section 6 and Regulations	Section 12(7)	Treasury Guidelines	Code of Conduct	Section 2.2 Code of Corporate Governance		Sections 17 and 18
Role of ex-officio members defined						Treasury Guidelines				Section 18(3)
- membership allowed										
- membership prohibited					Section 12(7) (vii)					
- membership allowed conditionally	Section 32	Regulations (Schedule 3)		Regulation 8			Code of Conduct	Code of Corporate Governance	Section 17(3)	Sections 18(3) and (4)
- membership as observers										
Role of ministers as board members defined										
- membership allowed										
- membership prohibited	Section 14(2)				Section 12(7) (vi)				Section 17(5)	
- membership allowed conditionally		Regulations (Sched 3.1)		Regulations 8 and 12(2)						Section 18(3)
Removal process for directors	Section 14(6)	Section 25 and Regulations		Regulation 14	Section 12(13)	Treasury Guidelines	Code of Conduct			Section 19(3–6)
Roles and responsibilities of directors	Sections 13, 15, 16, and 17	Sections 16–19	Sections 57, 105, and KPI	Section 6 and Regulations 17–32	S 46C(2)	Section 5, Treasury Guidelines, Companies Act	Sections 6, 16, 17, 19, and 19A, and Code of Conduct	Code of Corporate Governance, Companies Act and Establishing Legislation	Sections 14, 15, and 16	Sections 20, 25, and 26

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Issue	TON	SAM	FIJ	SOL	PNG	NZL	JAM	MUS	KIR	RMI
Managing conflicts of Interest	Section 13(2)	Sections 20, 21, and Regulations		Regulation 25		Companies Act	Code of Conduct	Section 2.4 Code of Corporate Governance		Sections 24 and 28
Appointment of CEO	Section 26		Section 34						Section 27	Section 27
Role of CEO	Section 26						Code of Conduct	Section 2.6 Code of Corporate Governance		
Establishment of the Audit Committee		Regulations (Schedule 8.6)					Section 8, S 9, and Code of Conduct	Section 3 Code of Corporate Governance		
Appointment of responsible minister		Section 2		Section 2	Section 2	Section 2		Section 2 Statutory Bodies (Audit & Accountability) Act and Section 2 Financial Reporting Act	Sections 2 and 12	Section 7
Roles and responsibilities of responsible ministers	Sections 8, 9, 10, 11, and 23		Sections 49, 58, 78, 109, and Schedule 2	Sections 7, 11, and 12				Section 3 Statutory Bodies (Audit & Accountability) Act	Section 12	Sections 7 and 14
Roles and responsibilities of shareholding ministers		Sections 6 and 31				Section 6				Section 7
Roles of shareholders who are not ministers			Sections 61– 67		Sections 12, 46C, 46E, 46G, 46H, and 46I					
Monitoring										
Establishment of the Monitoring Unit		Section 2			Sections 6, 7, 8, and 9				Section 29	

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Table *continued*

Issue	TON	SAM	FIJ	SOL	PNG	NZL	JAM	MUS	KIR	RMI
Monitoring unit requirements / powers		Sections 24, 26, and 28	Section 109		Section 9		Sections 5B and 7A	Office of Public Sector Governance, National Committee on Corporate Governance, Sections 19, 76, and 78 Financial Reporting Act		
Requirements defining content and approval of:										
- business/ corporate plans	Section 18	Section 22 and Regulations	Sections 89–92		Section 46E		Section 7 and Code of Conduct	Sections 4A and 6A Statutory Bodies (Audit & Accountability) Act, and Code of Corporate Governance		Section 12
- statement of corporate objectives/intent		Regulations (Schedule 5.5)	Sections 93–99	Section 13		Section 14			Section 19	Section 11
- annual report	Sections 19 and 20	Section 23 and Regulations (Schedule 6)	Sections 101–104	Section 14	Section 45 and Companies Act	Section 15	Sections 22 and 3(2)	Sections 6A, 8, and 9 Statutory Bodies (Audit & Accountability) Act	Section 20	Sections 31, 32, and 34
- audit requirements	Section 24	Section 27	Section 100	Section 20				Part VI Financial Reporting Act; Section 8 Statutory Bodies (Audit & Accountability) Act	Section 23	Section 33
- performance audit/review		Section 24					Sections 12, 13A, 13B, and 23	Section 5 Code of Corporate Governance	Section 18	Section 33(6)

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Table *continued*

Issue	TON	SAM	FIJ	SOL	PNG	NZL	JAM	MUS	KIR	RMI
Reporting requirements to parliament	Section 22	Section 22 and Regulations (Schedule 6.7)	Section 106	Section 17		Section 17	Sections 5 and 5A	Section 8 and Code of Corporate Governance; Section 9 (2) Statutory Bodies (Audit & Accountability) Act	Section 24	Section 33(5)
Other										
CSO defined	Section 4	Section 9	Sections 69, 70, 71, and KP1	Section 2		Section 7			Sections 2 and 6	Section 15
Explicit CSO policy	Section 4A	Sections 9–13 and Regulations		Regulations 33–37					Section 2	Section 15
Ability for monitoring agency to recommend policies and procedures binding on SOEs		Section 26						Code of Corporate Governance		
Penalties for noncompliance		Section 13, 19, and 25		Section 6(8) and 8 (4)				Section 79 Financial Reporting Act		
Sale or disposal of main undertaking or subsidiaries			Sections 54 and 55						Section 13	Sections 12 and 13
Clarifies priority where SOE conflicts with entity-specific legislation	Section 6 (2)	Composition Act		Sections 25 and 26					Section 36	Section 4
Mandatory publication of summary of SCI and annual report	Section 22 (2)			Section 18				Code of Corporate Governance		Section 34(6)

CEO = Chief Executive Officer, CSO = Community Service Obligation, FIJ = Fiji, IPBC = Independent Public Business Corporation, JAM = Jamaica, KIR = Kiribati, KP = Key Principles of SOE Reform, MUS = Mauritius, NZL = New Zealand, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, SAM = Samoa, SCI = Statement of Corporate Intent, SOE = state-owned enterprise, SOL = Solomon Islands, TON = Tonga.

[a] All New Zealand SOEs are registered under the Companies Act

[b] Guidelines developed by the Crown Company Monitoring & Advisory Unit before being absorbed into the Treasury.

[c] Code of Conduct is not binding on SOEs or the government.

[e] Includes guidance notes for SOEs issued in December 2006.

Source(s): Relevant legislation guidelines, and codes of countries participating in the survey.

Appendix 5

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT CORPORATE GOVERNANCE GUIDELINES 2015 UPDATE

MAJOR RECOMMENDATIONS FROM THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT GUIDELINES ON CORPORATE GOVERNANCE FOR STATE-OWNED ENTERPRISES: 2015 UPDATE[1]

State Ownership

- The ultimate purpose of state-owned enterprises (SOEs) should be to maximize value for society through an efficient allocation of resources.
- Governments should adopt an ownership policy defining the rationale for state ownership, the state's role in governance, and how the state will implement its ownership policy.
- The state should define the rationale for owning individual SOEs and subject that to regular review.

State's Role as Owner

- Governments should allow SOEs full operational autonomy to achieve their defined objectives.
- Exercise of ownership rights should be centralized in a single ownership entity.
- The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each SOE.

State's Role in the Marketplace

- There should be a clear separation between the state's ownership function and other functions.
- Costs related to public policy objectives should be funded by the state and disclosed.
- SOE's economic activities should face market-consistent conditions regarding access to debt and equity finance.
- SOE's economic activities should be required to earn rates of return consistent with those obtained by competing private enterprises.
- Where SOEs are engaged in public procurement, procedures should be competitive, nondiscriminatory, and transparent.

Shareholder Relationships

- SOEs should observe a high degree of transparency, including equal and simultaneous disclosure to all shareholders.
- The state and SOEs should treat all shareholders equitably.

Disclosure and Transparency

- SOEs should report material financial and nonfinancial information in line with internationally recognised standards of corporate disclosure, including
  - a statement of objectives and their fulfilment;
  - remuneration of board members;
  - board member qualifications, selection process, and roles on other boards or agencies;
  - foreseeable risk factors and mitigation actions;
  - financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public–private partnerships; and
  - material transactions with the state.

The Board

- The Board should be assigned a clear mandate and ultimate responsibility for the SOE's performance.
- Board composition should allow for the exercise of objective and independent judgement.
- Mechanisms should be implemented to avoid conflicts of interest.
- The Board should undertake an annual, well-structured evaluation of its performance.

[1] Organisation for Economic Co-operation and Development. 2015. *Guidelines on Corporate Governance of State-Owned Enterprises: 2015 Edition*. Paris.

Finding Balance 2016

Benchmarking the Performance of State-Owned Enterprises in Island Countries

Pacific state-owned enterprises (SOEs) are often formed to increase service delivery effectiveness and accountability. However, historical and financial indicators show that long-term government ownership of SOEs often result in outcomes counter to these goals. Weak governance and regulatory frameworks make it difficult for SOEs to operate on strict commercial principles over the long term. This fifth study of SOE performance in the Pacific emphasizes political commitment to reform as a key driver for commercial results, as demonstrated by the experience of each of the countries benchmarked. This report was produced by the Pacific Private Sector Development Initiative, a regional technical assistance facility cofinanced by ADB, the Government of Australia, and the Government of New Zealand.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to half of the world's extreme poor. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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