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INTEROIL FUEL SUPPLY FIASCO — THE NEED FOR COMPETENCY IN POLICY ARTICULATION, DESIGN, AND IMPLEMENTATION

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Introduction

The purpose of this paper is to demonstrate the need for competency in policy articulation, design, and implementation in Papua New Guinea, particularly in relation to the current InterOil fuel supply fiasco. In 2005, the National Research Institute (NRI) began pushing the case for competition in Papua New Guinea. In that respect, NRI has had extensive dialogue with the Independent Consumer and Competition Commission (ICCC) on this matter.

By and large, the ICCC has been mandated to promote competition in the economy. This is an important role, as competition is fundamental to innovation, fair pricing, and the improved provision of goods and services in the country. Overall, competitive markets propel economies on a path of sustained economic growth and development. Recently, Papua New Guinea has witnessed the amazing power of competition, with the entrance of Digicel into the mobile

phone market.

The need for the introduction of competition in other sectors of the economy, such as the airline industry, internet communication, and the water and electricity markets remains topical.

This paper will provide an analysis of the developments that led to the current fuel supply stalemate with the intention of demonstrating the need for sound policy articulation, design, and implementation in Papua New Guinea. It highlights the weaknesses and faults in the state's policy and decision-making process, the problems associated with ICCC's policy analysis process, and the lack of corporate responsibility on the part of InterOil (PNG) Ltd (hereafter referred to as InterOil). The paper concludes by making suggestions for improving future policy development in relation to the fuel market and other sectors of the economy.

**The National Research Institute—developing policies for national development,
good governance, and more informed decision making**

Faults with the State

Although we do not have access to the full corporate dealings and information, we understand that the State entered into a contractual agreement with InterOil regarding the supply and pricing of fuel, giving a monopoly power to InterOil, for a period of 30 years. Such contractual arrangements are particularly bad for the economy because they curtail competition.

The State should refrain from entering into contractual agreements that have the potential to harm the economy. This is crucial, given our voluntary membership to international organisations such as the World Trade Organisation (WTO), and regional bodies such as the Asia Pacific Economic Community (APEC). The State should confine itself to facilitating enterprise development with appropriate regulatory frameworks that are fair to all participants.

Faults with the ICCC

In an article titled: *'What's wrong with the ICCC'* which was published in the *Post Courier* (8 March 2006), NRI challenged the ICCC to review its decision to allow InterOil to purchase Shell (PNG) Ltd. The purchase of Shell (PNG) Ltd followed the purchase of BP (PNG) Ltd by the same company, InterOil, within a space of several months. This empowered InterOil as the dominant distributor of fuel supplies in Papua New Guinea. By that time, the oil distribution market had shrunk from five during the early 1990s to just three — Niugini Oil Ltd and InterOil in the

Highlands Region, and Mobil (PNG) Ltd and InterOil in other parts of the country. This status quo has remained up to the present.

The ICCC was warned that InterOil, being the owner of the only oil refinery; that is, fuel processing plant, in the country, was going to take complete control of the entire market chain — **production, wholesale, and retail** — of fuel.

The possible consequences that NRI predicted were — exposure to supply inconsistencies price hikes, and disruptions to the smooth flow of economic and other activities that require fuel. All that NRI predicted indeed happened last week.

What is far more fundamentally wrong is the lack of foresight and understanding of the potential impact that the agreed contract on the price of fuel was going to have on the market, by the ICCC. This had the potential to seriously curtail competition. The ICCC should have pointed out to the Government at that time, that this agreement was anticompetitive.

The ICCC's lack of understanding of the significance of this issue was magnified when it proceeded to approve the purchase of both BP (PNG) Ltd and Shell (PNG) Ltd by InterOil. This arrangement offered InterOil the market dominance, which severely restricted competition. This was a fundamental mistake on the part of the ICCC. As we then predicted, InterOil is now behaving as a typical monopolist, taking advantage of the market power that it has been offered.

Lessons for future policy development

The key lesson from the InterOil fuel supply fiasco is that decisions which have far-reaching implications for the nation's welfare should be properly analysed, articulated, packaged, and implemented in a transparent process. Policy makers need to be reminded that theory and empiricism are critical for sound and objective policy formulation and implementation.

While the lessons from the fuel fiasco should be used to improve the weaknesses within the ICCC — be they legal or technical — the Government should be careful not to repeat similar mistakes in the other key economic sectors, such as telecommunications, airlines, electricity, and gas.

The Government should clearly define, and make public, its policy on market deregulation. So far, a vague statement — public-private partnership — is being widely mentioned by politicians. This needs to be clearly articulated and widely circulated for wider public scrutiny.

This remains the surest way for making improved and objective policies that meet the needs of all concerned stakeholders.

About the Authors

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Recently launched NRI Bibliographies

Bibliography No. 9: 'Educational Reform in Papua New Guinea', compiled by Patricia Paraide.

Bibliography No. 10: 'Population Studies in Papua New Guinea, 1966–2005', compiled by Esther Lavu.

Bibliography No. 11: 'Corruption in Papua New Guinea', compiled by Albert Ayius.

Bibliography No. 12: 'Security Issues in Papua New Guinea and the Asia-Pacific Region', compiled by James Laki.

Bibliography No. 13: 'Transport in Papua New Guinea', compiled by Agogo Mawuli and Lindsay Kutan.

Bibliography No. 14: 'Land in Papua New Guinea', compiled by Charles Yala and Lindsay Kutan.

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Key lessons in policy analysis and decision making

The preceding analysis shows that a poor decision on the part of the State to enter into a pricing agreement with InterOil, followed by a series of faulty decisions by the ICCC, has resulted in the current stalemate.

Ideally, InterOil should have been allowed to refine, wholesale, and retail fuel in a competitive environment. This would involve refraining from entering into agreements on the supply and pricing of fuel, and allowing other distributors, such as Mobil, Niugini Oil, and BP, to have the freedom to either purchase fuel from InterOil or import their supplies from external sources.

Competition at the wholesale stage would have led to competitive fuel prices and consistency of supply at the retail stage. Unfortunately, the contractual agreement on the price of fuel and the purchase of two major fuel distributors (BP and Shell) offered InterOil exclusive market power in the production, wholesale, and retail chain.

This demonstrates the consequences of bad decisions that lack theory, empiricism, and transparency in the policy formulation process. This should be a warning to the current and future governments to avoid engaging in actions that provide monopoly power to one enterprise.

The Government should confine its role to establishing and administrating the institutional frameworks that promote competition. Also, the ICCC should adhere to its responsibility to promote and safeguard competition, as mandated by the *ICCC Act*. Using this current opportunity, the ICCC should review all its past decisions concerning the fuel industry, with a view to introducing competition in the sector.

InterOil — a bad corporate citizen

The recent action by InterOil not only depicts the behaviour of a typical monopolist, but also

portrays an irresponsible attitude of a bad corporate citizen. In the present case, InterOil has held the country to ransom at a time when there is a major natural disaster in Oro Province, which requires fuel for the urgent delivery of food, shelter, and medical supplies.

The profit maximising ‘needs’ of the shareholders of a monopolist organisation should not be used to penalise the rest of the country’s need for a fairly priced and consistent supply of fuel. Such a scenario highlights the need for competition (by a sufficient number of suppliers), where there is little possibility of consumers being held to ransom by any individual corporate entity.

The actions taken by InterOil in the recent days amount to a breach of contract. The State should seek redress for the breach of contract. Moreover, the threat by InterOil to restrict fuel supply, unless its pricing proposal is accepted, amounts to corporate blackmail and therefore, deserves strong condemnation.

The need for an investigation

The current fuel supply fiasco is the result of bad decisions made by the State, InterOil, and the ICCC. Given the importance of fuel in the economy and the need to promote competition, the Government should consider instituting an independent investigation.

This is particularly important, because the contents of the initial contract remain confidential. A monopolist is using its powers to blackmail the State, and the ICCC has approved a faulty transaction that is in breach of its legally mandated responsibility — to promote competition.

It is only through an independent investigation that the public can be informed of the facts, and the findings would be useful when promoting competition in other sectors of the economy, and avoiding repetition of similar mistakes.