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## The Public Enterprise Sector

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### Introduction

When the Government of Tuvalu (the Government) presented its public sector reform program in the *Kakeega o Tuvalu* (GOT 1995), it was the sole owner of seven public enterprises and effectively controlled the Tuvalu National Provident Fund (TNPF), which is owned by its members. These eight enterprises collectively accounted for about half of marketed GDP at the time, so that their performance greatly affected economic efficiency and service delivery (ADB 1998). Introducing performance-oriented corporate planning in these enterprises was a key component of the public sector reform program, along with formulating appropriate pricing policies for public services. Additionally, the Government identified a range of initiatives for commercializing, corporatizing, and contracting out public service provisions (GOT 1995, p.16):

- (i) issuing shares in NBT to private investors, including foreign banks;
- (ii) privatizing the Government Travel Office;
- (iii) commercializing and subsequently corporatizing *Nivaga II*;
- (iv) leasing or selling the Vaiaku Lagi Hotel;
- (v) privatizing or contracting out some Public Works Department services;
- (vi) corporatizing the Post Office and amalgamating it with the Philatelic Bureau;

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- (vii) privatizing commercial fisheries, involving the lease, sale, or closure of the National Fishing Corporation of Tuvalu and the Teone fish market;
  - (viii) commercializing and subsequently corporatizing the Broadcasting and Information Office;
  - (ix) managing the Vaitupu Fishing Centre;
  - (x) commercializing and corporatizing Government housing;
  - (xi) contracting out stevedoring and port services; and
  - (xii) contracting out fisheries research activities.

The Government's commitment to reforming the public sector was reiterated in the 1997 *Vision 2015* statement (GOT 1997a) and elaborated in the 1997 *Amatuku Plan* (GOT 1997b and 1997c). However, few of the initiatives listed above were taken between 1995 and 2001:

- (i) the Broadcasting and Information Office was corporatized into the Tuvalu Media Corporation in 1999;
- (ii) a private travel company, Manu Travel, began arranging travel for some government departments in 2000;
- (iii) some PWD services like maintaining government-owned property were contracted out; and
- (iv) the Tuvalu Maritime School was corporatized into the Tuvalu Maritime Training Institute (TMTI) by an Act of Parliament in July 2000.

Corporatizing the Post Office and amalgamating it with the Philatelic Bureau is expected after the 2002 general election.

Therefore, in early 2002, there were 10 100% Government-owned public enterprises operating under their own Acts of Parliament (Table 4.1). Most, if not all, of these enterprises are likely to remain in the public sector, so that reform of the public enterprise sector will continue to focus on improving its performance without changing state ownership. This Chapter

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- (i) examines the operations of the 10 public enterprises since 1996;
  - (ii) assesses the extent to which corporate governance has improved; and
  - (iii) discusses removing constraints to improve corporate governance.

### **The Rationale for Corporatization**

The first step in improving corporate governance in the public enterprise sector is to separate and clarify the roles of owner (the principal) and manager (the agent) (Schiavo-Campo and Sundaram 2001). The intention of the separation is to allow the manager to manage, without the owner interfering unduly in daily operations. The owner is to ensure the enterprise maximizes benefits to society, and should confine interventions to strategic issues.

Corporatization separates roles by creating an independent legal identity for the agency delivering services, either as a public corporation established by an Act of Parliament, or as a public company incorporated under companies legislation, with the Government owning 51% or more of voting shares. However, more than legislative change is needed if roles are to be fulfilled effectively and corporatization is to generate efficiency gains.

In particular, the principal-agent problem has to be solved. This problem exists when the welfare of the principal is influenced by the agent, who knows more about the enterprise's operations than the principal but who cannot be relied upon to act in the owner's interest. Therefore, granting autonomy to the manager of a public corporation must be matched by effective control, monitoring, and reporting mechanisms that make enterprise management accountable. The control function is exercised by boards of directors that walk a fine line between conflicting demands, as Schiavo-Campo and Sundaram (2001, p.205) observe:

Table 4.1: List of Public Enterprises, 2002

Enterprise	Origin	Governing Legislation
National Bank of Tuvalu	Subsidiary of Barclays 1980-85; joint venture GOT (60%)- Westpac (40%) 1985-95; 100% GOT 1995-present	NBT Act 1980
Tuvalu National Provident Fund	Original business	Provident Fund Act 1986
Development Bank of Tuvalu	Took over assets and liabilities of the Business Development Advisory Bureau in 1993	DBT Act 1990
National Fishing Corporation of Tuvalu	Fisheries division of Government ministry	NAFICOT Act 1982
Tuvalu Philatelic Bureau	Transferred from Post Office in 1985	Tuvalu Philatelic Act 1982
Vaiaku Lagi Hotel Corporation	Government ministry	VLHS Act 1988
Tuvalu Electricity Corporation	Government ministry	Tuvalu Electricity Act 1990
Tuvalu Telecommunications Corporation	Government ministry	TTC Act 1993
Tuvalu Media Corporation	Broadcasting and Information Office of Government ministry	TMC Act 1999
Tuvalu Maritime Training Institute	Tuvalu Maritime School in Ministry of Education	TMTI Act 2000

Source: GOT.

*They must exercise their legal oversight responsibility, but without stifling the initiative of the management; and they must represent the interests of the state, but without becoming involved in the operational affairs of the company. Their capacity*

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*to walk that line depends far less on the structure of the board than on the capacity of its members, the quality of information and resources they have, and the degree of government support they receive.*

Additionally, because management quality really determines whether corporate objectives are achieved, public enterprise management itself must be improved through a transparent selection process, training, and a focus on performance. Performance evaluation of management should extend to independent feedback to Government from employees and consumers. As noted, management possesses more relevant information than the Government and therefore can mount convincing but misleading explanations of its performance.

In sum, corporatization is a means to a more commercial public service delivery, while allowing the Government, as owner, to guide strategic management decisions. This guidance may include a requirement to undertake a "community service obligation" that is commercially unprofitable (and which may attract an explicit Government subsidy to the public corporation). Necessary conditions for successful corporatization include

- (i) clear objectives and roles for ministers, boards, and general managers;
- (ii) autonomous management with only rare ministerial intervention in routine operations;
- (iii) strict accountability for performance; and
- (iv) competitive neutrality with services provided on the same terms as actual or potential private sector providers (Economic Insights 1998).

The ultimate purpose of corporatization is to increase the productivity of resource use, which is reflected in lower prices for services and/or a higher quality of service. Higher productivity also potentially

permits higher staff wages and increases revenue flow to the Government (or reduces the drain on the public purse). Corporatization must be judged by whether or not the purpose is achieved.

## Operations and Performance of Public Financial Institutions

The National Bank of Tuvalu (NBT) and TNPF are exceptions to the general rule that public enterprises in Tuvalu originally were Government departments or divisions. NBT was a joint venture with Barclays Bank and then with Westpac between 1980 and 1995, prior to the Government becoming the sole owner (Table 4.1), while TNPF was created as a new enterprise in 1984.

The **National Bank of Tuvalu** (NBT) was established as a corporate body by a 1980 ordinance, which specifies that "the Bank shall act in accordance with any policy directions in the national interest given to it from time to time in writing by the Minister [of Finance]" (GOT 1982). A board of directors consists of the secretary for finance and four others (excluding members of Parliament) appointed by the minister for periods determined by the minister. Board meetings are scheduled for at least every 6 months. The board is required "to ensure that Bank policy is directed towards the national interest and has due regard to the stability and balanced development of the economy of Tuvalu." Board members are empowered to decide their own fees and allowances, subject to ministerial approval; and the board appoints a general manager for up to 5 years. The general manager must attend board meetings but has no voting rights, and in 2001 presided over a staff level of two managers (finance and administration, and lending and operations) and 38 officers, clerks, and tellers.

An annual report and NBT's financial accounts are by law prepared within 6 months of the end of the financial year, and the accounts are audited by an external agency selected by the board with ministerial

approval. The minister presents the annual and audit reports to Parliament. NBT's reporting has been reasonably timely.

As noted in Chapter 2, NBT has operated profitably, returning an average 58.3% on net assets before tax from 1990 to 2000, and contributing an annual average of \$507,000 to the Government in company tax and dividends. It is the only public enterprise to return a dividend to the Government consistently.

Also as noted in Chapter 2, NBT's status as a public (and perhaps natural) monopoly inevitably means relatively high interest rate spreads, fees, and commissions, and possibly a lower quality of banking services than in a more competitive banking sector. Although for the latter, staff exchanges with the ANZ bank in the Fiji Islands permit informal benchmarking. Appointing an experienced overseas bank executive as a visiting board director would be a formal way of introducing a comparative perspective (Tuvalu Trust Fund Advisory Committee 2001). Monopoly pricing disadvantages consumers and hinders private sector development, the board and the minister need to understand the national interest. Presently, this means equating the national interest with what is good for the Government. This reflects the importance of NBT as a revenue generator in a public enterprise sector that otherwise is a revenue absorber. In addition, while there is no suggestion of declining prudential standards, it would be appropriate to arrange for regular and independent prudential supervision, using regional assistance, as suggested by the TTF Advisory Committee (TTFAC) (2001).

The principal activity of the **Tuvalu National Provident Fund** (TNPF) is receiving member contributions and their investment in financial assets through professional fund managers. A six-person board of directors including NBT's manager is responsible for overseeing the Fund's operations. TNPF membership and net worth grew substantially between 1984 and 2000, with the return on net assets averaging 9.2% (Chapter 2). However, poor results in 2000 prompted a reorganization of the Fund's investment portfolio. TNPF management is eager to complete installing an effective management information system. But by

early 2002 a computer-based system introduced in 2001 remained incapable of generating reliable information. A cumbersome manual system is used with persistent discrepancies between members' contribution account balances in the general ledger and the members' subsidiary ledger—with consequent qualified audit opinions on the 1999 and 2000 financial accounts.

The **Development Bank of Tuvalu** (DBT) was established under a 1990 Act as a general banking business to promote participation of Tuvaluans in economic and social development, especially rural, export oriented, or import substituting development. DBT's policy is determined by a six-member board of directors that includes three public servants and three representatives of the private sector (including a minister of religion and two businesspeople). The board appoints a general manager and support staff responsible for daily operations. Originally, there was provision for eight staff, and in January 1999 there were 15.

In contrast to NBT and TNPF, DBT has been unprofitable since its opening in June 1993 when it took over the assets and liabilities of the Business Development Advisory Bureau (Chapter 2). An operating profit was reported in 1999, but this reflected the impact of a \$295,000 government grant. In fact, there was a bottom-line trading loss of over \$200,000. A task force review of DBT presented to the board in May 2000 pointed to "unfortunate malpractices by past staff members and the inability of staff to perform to standards required by DBT" as major problems (DBT 1999). The general manager and the manager of finance and administration had resigned in December 1999, and there were several other vacancies. Record keeping was so poor that the officer in charge of DBT could not assess which loans were nonperforming.

There have been efforts to revitalize DBT business. A clear and forceful *Statement of General Business Policies* was issued with board approval in January 2000 and, if acted upon consistently, would lead to sound lending practices. Early in 2000, the loan portfolio of \$1.6 million was segregated into performing and nonperforming components.

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Volunteers under the Australian Executive Service Overseas Program helped in this effort to improve loan recovery. A move to a computer-based management information system was underway, again with external assistance. However, an operating loss of \$112,000 was recorded in 2000, and at yearend accumulated losses totaled \$1 million, net worth was minus \$77 million, and arrears, although down on previous years, were still 17% of the loan portfolio. Prospects for achieving sustained profitability seemed limited, even with a new general manager, in-house training, and cautious lending resuming following the 1999 freeze. As observed in chapters 2 and 6, the 1998 proposal to merge DBT with NBT should be revisited for possible economies in administration.

## Operations and Performance of the Utilities

The Public Works Division of the Ministry of Works, Communication and Transport remains responsible for public provision of water and sewage services. Most of Tuvalu's water supply comes from private rainwater storage and its sewage is provided by individual septic tank systems. Public utilities operate in the power and communications sectors and, after NBT, are the largest corporations by turnover (ADB 1998).

The **Tuvalu Electricity Corporation** (TEC) is responsible for generating and distributing electricity on Funafuti, Amatuku (the TMTI site) and, since the successful rural electrification project of 2000, all outer islands (except the almost uninhabited Niulakita). TEC also sells electrical appliances. The Corporation is guided by a four-member board of directors reporting to the minister of environment, energy, and tourism (prior to 2002, the minister of works, energy, and communications). The board consists of two public sector and two private sector representatives and appoints a general manager, who is supported by a deputy manager (the chief engineer) and a staff of 31 on Funafuti and Amatuku, and 24 on the outer islands. Salary levels are set under the civil service

structure, with the general manager paid at level three (equivalent to senior crown counsel and in the range of \$14,697 to \$15,555 per annum in 2002).

In early 2002, four of the established TEC positions on Funafuti were vacant, including that of accountant; a position unfilled since its creation in 2000. That this position was not created until 2000 and was not filled is partly why TEC's financial accounts have not been prepared and accepted for audit since 1995—despite governing legislation requiring accounts to be prepared within 6 months of a fiscal year ending. Similarly, annual reports have not been presented to Parliament via the minister as prescribed in legislation. Not surprisingly, TEC is criticized by consumers and government officials for its lack of accountability and transparency (TTF Advisory Committee 2002).

Evidence shows that TEC has been operating at a loss. The average return on net worth was minus 4.6% from 1990 to 1996 (ADB 1998); and in-house accounts show operating losses in each subsequent year up to and including 2001. To some extent, losses may be desirable: the economies of scale in the electricity sector are so large that a (natural) monopoly is inevitable. In such a situation, adopting a marginal cost pricing policy for economic efficiency must mean that prices are set below the average cost of production. Additionally, services may be provided at a price below cost to disadvantaged groups (for example, outer-island populations), although the argument loses weight if nondisadvantaged groups also benefit from the below-cost price. When decreasing costs exist or there is a valid equity argument, there is a case for government subsidies funded from general revenue (Coase 1970).

However, neither marginal cost pricing nor equity-based pricing are explicit TEC policies; and while the theoretical case for a policy of allowing a public enterprise to make losses may seem reasonable, there are implementation problems of measurement and application. There are also risks that adopting such a policy would encourage management to maintain an excessively costly operation, and to perhaps overinvest in supply capacity (since there is no need to achieve a viable rate of

return on funds). These are key reasons why governments generally have moved towards greater cost recovery for state enterprises and in some instances established target rates of return on assets employed.

Management began preparing a strategic plan for TEC in 2000. The resulting document, *TEC Strategic Plan FY 2001*, remains incomplete because appropriate standards of performance were still to be agreed on by the board and the minister, and most of the historical data on performance indicators were missing. Nonetheless, missions and

#### Box 4.1: Summary of TEC Strategic Plan FY 2001

The new strategic direction for TEC is to provide power for development by extending the use of electricity and improving the quality of service and reaching appropriate standards of technical, financial, economic, and environmental performance.

The new direction is summarized by six key objectives:

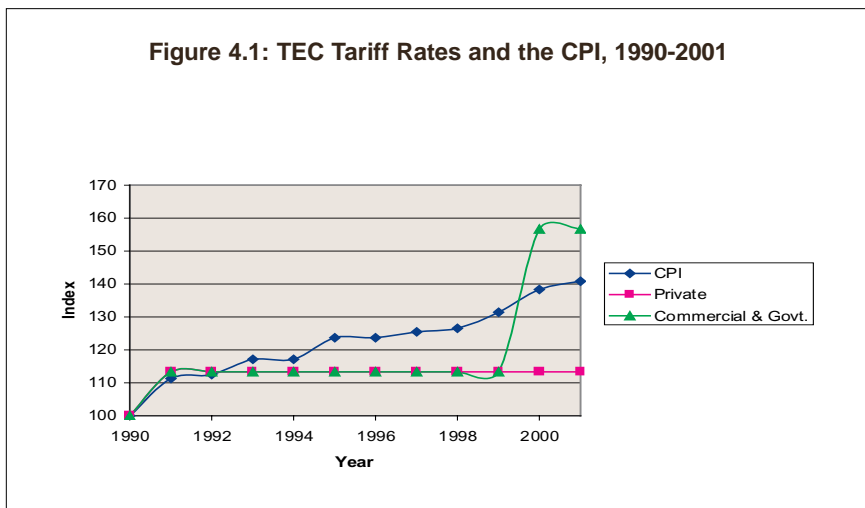
1. To improve consumer satisfaction by ensuring price increases are less than the inflation rate
2. To provide an electricity supply that meets reliability and quality targets (reduce power interruptions by 10% per annum)
3. To meet financial directions [*sic*]
4. To increase the number of people connected to power (at rates exceeding 3% per annum)
5. To actively market the effective use of the supply system
6. To increase the efficiency of our organization (as measured, for example, by the number of consumers per employee)

Source: TEC 2001.

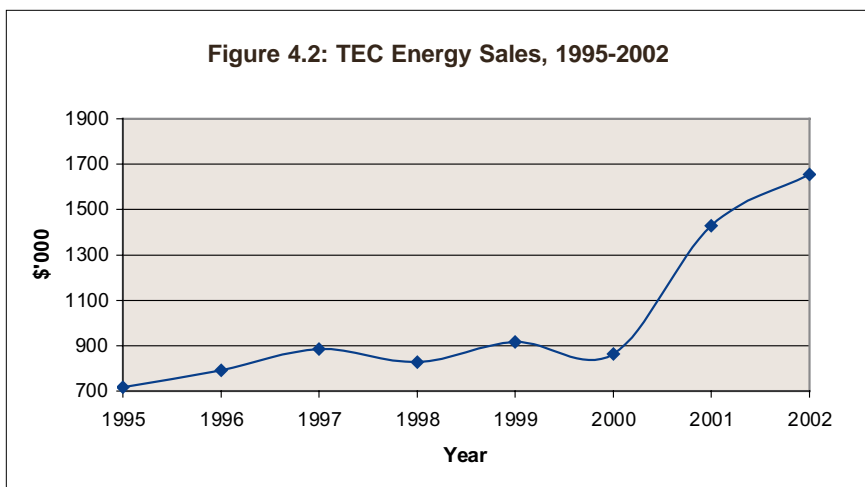
objectives were set out (Box 4.1), and a general commitment was made to upgrading the Corporation's human resources.

The pricing policy in the *TEC Strategic Plan* is "to contain price increases below the rate of inflation," to achieve the first objective of improving consumer satisfaction (TEC 2001, p.1). The electricity tariff started at 30 cents per kilowatt hour for all user groups in 1990; rose to 34 cents in the following year; and has remained at that level for private households in Funafuti, but was increased to 47 cents in 2000 for commercial and industrial users and the Government. The tariff for outer-island households is 30 cents. Therefore, as Figure 4.1 shows, the real price of power has fallen for households between 1990 and 2001, and risen for other user groups towards the end of the period. The uniform nominal rate charged before 2000 was about double the rate in the Fiji Islands, on a par with the rate in Samoa, and about 17% below the high rate in Tonga (ADB 2000). The substantial 2000 rise in rates for commercial users and the Government is a cost-recovery measure that is likely to be effective, since it affects those user groups whose demand can be expected to be relatively price insensitive. Simultaneously, the cross-subsidy to households is increased. In setting tariff charges, the major cost is fuel oil, which in 2001 accounted for 60% of total operating costs exclusive of depreciation.

Power supply in Funafuti is reasonably reliable by regional standards. In the early 1990s, there was an average of one 5-10 minute disruption per month. (ADB 1998). The number of interruptions declined until 1998, when there was an increase because of generator problems, and then reportedly fell again in subsequent years (TEC 2001). The limit of current generating capacity is now being reached as a result of recent growth in electricity consumption on Funafuti, and TEC proposes to expand capacity in the next few years. Total consumption increased from 2,328 kilowatt hours in 1996 to 3,392 kilowatt hours in 2001, a 7.8% average annual rate of increase. Between 1996 and 2001, household consumption grew at 14.3%, commercial consumption at 4.9%, and government consumption at 4.7%.



Source: TEC 2001.



Source: TEC accounts.

Note: The 2002 figure is a budget estimate.

Figure 4.2 shows energy sales from 1995 to 2002. The creation of generating capacity in the outer islands contributed to the rise in sales in 2001; but most of the growth was concentrated on Funafuti (which accounted for 90% of country-wide sales), and largely reflected the impact of the higher tariff for commercial users and the Government. Sales revenue from these two groups rose above the 2000 level by 59% and 53%, respectively, while revenue from households increased by 33%. In 2001, private households accounted for 30% of total energy sales, commercial and industrial users for 37%, and the Government for 33%. Compared with 1996, there was a slight increase in the sales share of households.

Greater cost recovery of the sort begun in 2000, and reflected in the 2001 sales revenue increase, will be essential to improving TEC's financial performance and reducing government subsidies. The 2001 national budget showed a \$200,000 subsidy to TEC as a special development expenditure, and also \$588,000 as special development expenditure on outer-island electrification through the Ministry of Natural Resources, Energy and Environment (MNREE). The 2002 national budget reveals that the 2001 subsidy actually turned out to be \$285,000, and shows estimates of special development expenditure that include a \$1.2 million subsidy to TEC and \$500,000 in expenditure through the new Ministry of Environment, Energy and Tourism (MEET) for the second phase of outer-island electrification. TEC should be accountable for its use of public funds, and for greater clarity on the respective roles of TEC and the ministry. A service operating agreement between TEC and the Government should be negotiated and implemented. This would cover the following areas (see Economic Insights 1998):

- (i) objectives, nature, and scope of the Corporation's main activities;
- (ii) performance targets and other measures by which the Corporation's performance is to be judged under its stated objectives;

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- (iii) accounting policies to be applied;
  - (iv) broad financial guidelines and constraints, such as maximum debt to equity ratios;
  - (v) major infrastructure investments, their expected rates of return, and proposed financing arrangements;
  - (vi) proposals for varying the Government's equity contribution;
  - (vii) dividend policy;
  - (viii) noncommercial activities to be performed and the arrangements for costing, funding, and performance monitoring;
  - (ix) specific employment, wage, and industrial regulations requirements not reflected in general legislation;
  - (x) proposals for external technical assistance;
  - (xi) type of information for the Corporation to give to the minister during the financial year, including information in quarterly and half-yearly reports; and
  - (xii) such other matters as might be agreed on by the minister and the board.

**The Tuvalu Telecommunications Corporation** (TTC) was established in February 1994 under the TTC Act of 1993, which grants TTC a monopoly of telecommunications service provision in Tuvalu, as a commercial organization. TTC's corporate plan for 1997 to 2002 states its mission is "to provide efficient, reliable and cost effective telecommunications services to both domestic and international destinations, to the benefit of the people of Tuvalu and the social and economic development of the nation" (Economic Insights 1998, p.7). Direct dialing domestic and international services are available through the main exchange on Funafuti, as well as limited operator-assisted and phone card services. The exchange has a potential capacity to service over 2,000 subscribers, of which there were 740 by 1997. Outer-island and international calls use Intelsat satellites. Fax, telex, and telegraph services are also provided by TCC, but Internet and e-mail services have been removed to the Office of the Prime Minister (OPM), reportedly because

TTC was becoming "too powerful" (TTFAC 2002). As explained in Chapter 2 (Box 2.2), the registry of Tuvalu's top level domain name has been privatized.

A five-member board of directors of three Government and two private sector representatives oversees TTC operations. Although the numerical dominance of Government personnel potentially compromises the board's independence from Government, it appears that this has not been an issue in practice. Indeed, in 1997 the board decided to disconnect government telephones because of unpaid bills (Economic Insights 1998). The general manager acts as secretary to the board and is responsible for TTC operations. He is supported by four branch managers (finance, administration, operations, and engineering) and 50 other staff. This staffing level has been stable in the past five years.

The telecommunications tariff structure set by TTC (Table 4.2) is unchanged since a 1998 analysis that demonstrated large losses were made on outer-island and intraFunafuti calls, while profits were made on international calls (Economic Insights 1998). This same analysis shows that full cost recovery would have entailed massive hikes in rates for outer-island calls and a large rise in rates for intraFunafuti calls. Such hikes were regarded as inappropriate, given that capital costs were funded largely by external grants and that there was a community service obligation to outer-island populations. Rather, it was suggested that the tariff structure should ensure that revenue covered "critical costs" of Funafuti, outer-island, and international services. Critical costs are defined as cash costs actually incurred by TTC (the noncritical costs being depreciation). The implied tariff adjustment again involved large rises in rates for outer-island and intraFunafuti calls (although lower than for full cost recovery), alongside reduced rates on international calls. However, if the aim was to cover critical costs in total, as opposed to covering costs of each service category, TTC was already successful, since 1998 revenue covered costs exclusive of depreciation. Since then, the TTC board has maintained a policy of setting tariffs under affordability considerations and the need to cover critical costs.

Table 4.2: TTC Tariffs for Direct Dialling, 2002

Call Destination	Peak Rate (per minute)	Off-Peak Rate (per minute)
<b>Domestic</b>		
- within Funafuti	\$0.10 unlimited time	\$0.10 unlimited time
- outer islands	\$0.60	\$0.60
<b>International</b>		
- Australia	\$1.50	\$1.20
- Fiji	\$2.00	\$1.60
- other Pacific islands	\$2.50	\$2.00
<b>Rest of the world</b>	\$4.00	\$3.20

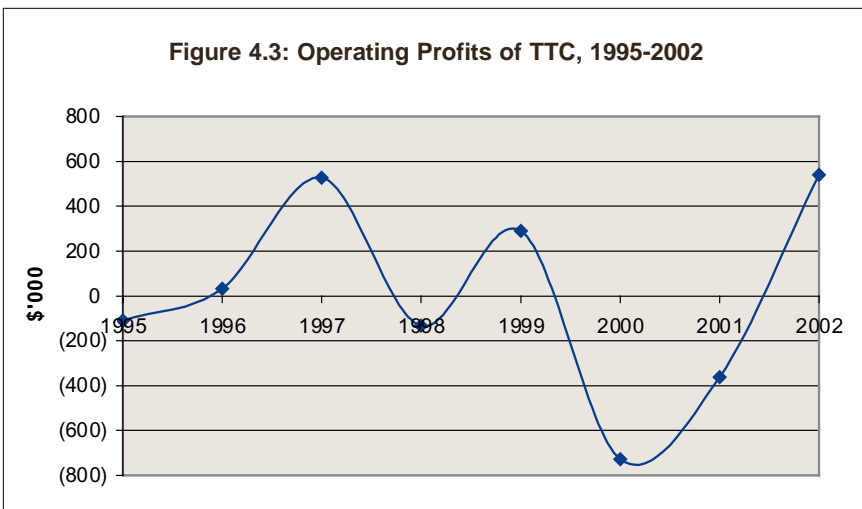
Source: TTC.

The TTC Act requires the board to prepare financial accounts and an annual report on operations within 6 months of the end of the financial year. The accounts are to be audited by the Auditor General and reported to Parliament at least once a year. These requirements have not been met. The last audited set of TTC accounts was for 1998, and the auditor was Peat Marwick. The audit reports for 1996 to 1998 are all qualified. In each report, it is noted that TTC "is unable to rely on its traffic system for completeness and accuracy of incoming and outgoing traffic. Total reliance is placed on foreign administrations to provide all incoming and outgoing traffic minutes. We are unable to satisfy ourselves that outpayments and inpayments are complete and accurate and the balance of traffic creditors and debtors is fairly stated" (Independent Auditors' Reports, 1996-1998). Additionally, in 1996 the record of transactions could not be verified because of a computer malfunction (which had a flow-on effect to the 1997 accounts), and the auditors were concerned that there was no independent valuation of the \$4.4 million in assets transferred to TTC in 1994.

Figure 4.3 shows TTC's profitability as revealed in the 1996 to 1998 accounts presented to the external auditors and in-house accounts

yet to be prepared for audit. It must be noted that there are major discrepancies in data provided from the two sources. For example, the financial statements presented for audit report an operating profit of \$318,562 in 1997. The in-house 1999 budget summary reports an operating loss of \$72,673 in 1997. The observation made in 1998 that "Computer-based information systems are poorly developed and records are manifestly inadequate" (Economic Insights 1998, p. 9) is still pertinent. TTC contributed \$60,000 to the Government in 1997, and received \$1.2 million in grants and aid between 1995 and 1998, which is included as income in the TTC accounts.

TTC management, like TEC's, has been accused of a lack of transparency and accountability (TTF Advisory Committee 2002). TTC, like TEC, should be working under a service operating agreement with the Government. Such an agreement complete with performance indicators was drafted in 1998 (Economic Insights 1998), but there seems to have been little follow-up action since then.



Source: TTC accounts.

Notes: The outcome for 2000 reflects a particularly large allowance for depreciation. Figures for 2001 and 2002 are budget estimates.

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## Operations and Performance of Other Public Enterprises

The Government's commercial fisheries arm the **National Fishing Corporation of Tuvalu** (NAFICOT) has had a history of decline, expansion, and renewed decline. The 1980s was characterized by unprofitable operations and deteriorating infrastructure and equipment. A brief period of profitability in the early 1990s was largely attributable to the leasing out of a long-lining vessel that was unprofitable domestically. From April 1994 to March 1998, assistance from the Japanese Overseas Fishery Corporation Foundation allowed NAFICOT to expand its operations by acquiring three fishing vessels and restoring infrastructure and equipment (ADB 1998). However, operations remained unprofitable and, with the ending of external assistance, it appears that there has been a renewed decline.

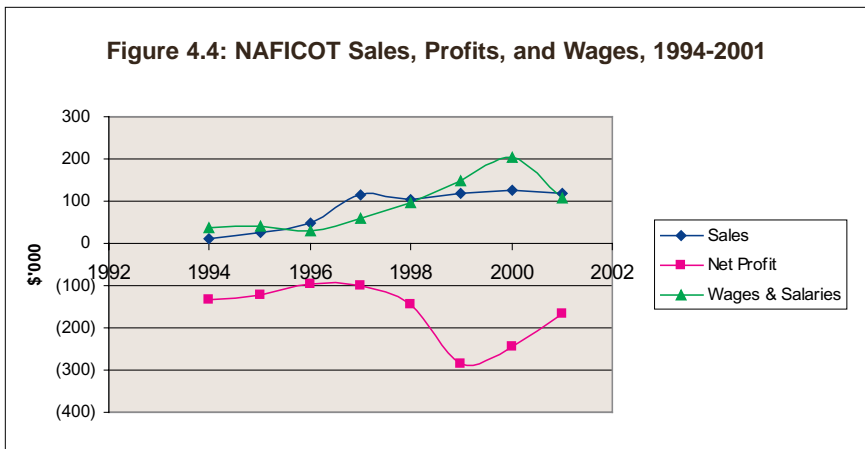
The last set of audited NAFICOT financial accounts is for 1992 (TTF Advisory Committee 2001). Accounts for 1993 to 1999 remained outstanding until early 2002, despite repeated requests from the six-member board of directors that they be completed under NAFICOT's governing Act. The general manager blamed lack of data and supporting documentation for delays in 1994, 1995, and 1996. Accounts presented for audit in early 2002 and additional in-house data show net losses for each year between 1994 and 2001. Losses have been incurred despite some growth in sales and, especially in 1999 and 2000, have been associated with large rises in the wages and salaries bill (Figure 4.4). This may be partly attributable to staffing community fishing centers in the outer islands (Chapter 6). NAFICOT's draft budget for 2002 indicates another year of loss-making operations is anticipated. A new fishing vessel is expected to increase sales revenue substantially through increased collections from the community fishing centers, but upgrading of infrastructure and equipment is needed, and the wage and salaries bill is estimated to rise by about two thirds from the reported 2001 level.

As discussed in Chapter 6, NAFICOT continues to offer fresh fish in Funafuti through two outlets leased at retail stores. NAFICOT vessels

and local fishers supply the fish. The corporation also operates a boat motor repair workshop, and sells ice and fishing gear. It is recommended in Chapter 6 that NAFICOT

- (i) sell its fishing vessels;
- (ii) lease its motor repair and gear sales facilities to private operators; and
- (iii) continue supporting private fishers with infrastructure like ice making, cold storage, and marketing services.

Whatever the future scope of NAFICOT operations, there is a pressing need now for greater accountability and transparency in its operations.



Sources: NAFICOT accounts; NAFICOT Proposed Annual Budget 2002.

The **Tuvalu Media Corporation** (TMC) was established by an Act in December 1999. Its functions are to continue the national broadcasting service "Radio Tuvalu" and any other business previously undertaken by the Government's Broadcasting and Information Division. The Corporation's charter (Box 4.2) states that the Corporation and its board

**Box 4.2: Tuvalu Media Corporation Charter**

- (1) The principal function of the Corporation shall be to provide a national broadcasting service which informs, educates and entertains the people of Tuvalu and, in doing so, reflects its commitment to the interests of Tuvalu.
- (2) The Corporation, in performing its principal function, shall:
  - (a) make all reasonable endeavors to maintain broadcasting services to all regions of Tuvalu and seek financial assistance by way of grant or loan from any person if the cost of extension of such services to remote areas renders this expedient or necessary;
  - (b) provide adequate coverage of news and information from all parts of Tuvalu and from overseas sources, including the widest possible range of perspectives and opinion in its broadcasts and publications;
  - (c) make its broadcasting facilities available as a means of communication ...if for any reason conventional telecommunications are unavailable;
  - (d) maintain a policy of social responsibility by having regard at all times for the interests of the people of Tuvalu and endeavor to accommodate or encourage these when able to do so;
  - (e) be accountable to the people of Tuvalu through their elected representative in Parliament.
- (3) The Corporation is not to be regarded as the servant or agent of the Government or ...as exempt from any tax, duty, rate, levy or any other charge whatsoever and that its property is not to be regarded as property of, or held on behalf of, the Government.
- (4) ...the Corporation and its board are not subject to direction by or on behalf of the Government or any Minister thereof.

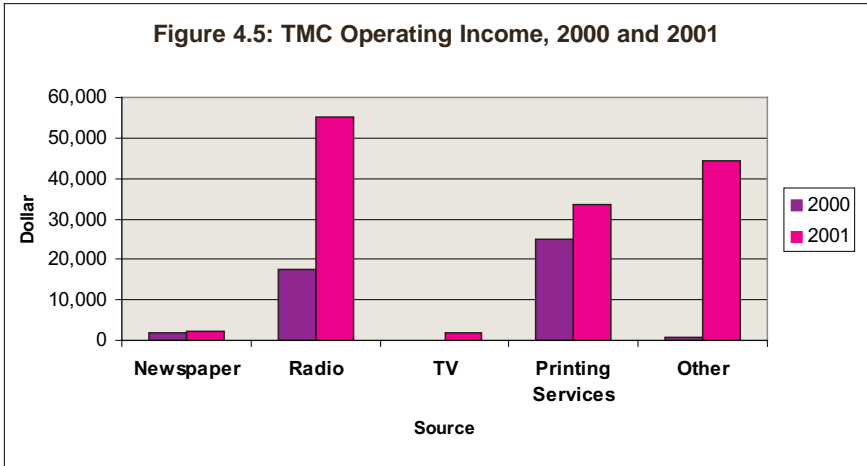
are not directed by or on behalf of the Government or any minister. However, all five board members are appointed by the minister, who also selects the chairperson and deputy chairperson and may terminate their appointments if the reasons are disclosed. TMC's chief executive is the general manager, appointed by the board with the minister's approval. The general manager's term is 3 years, but this can be renewed by the board, with the minister's approval. Permanent employees are appointed (and dismissed) by the board, which also sets their terms and conditions of employment. Because the chairperson is the permanent secretary of the responsible ministry, the Government maintains de facto control.

TMC is obliged by law to submit an annual report, including accounts and financial statements, for the minister to table in Parliament, but has so far failed to comply with this requirement. In 2000 and 2001, TMC relied heavily on government grants of \$234,750 and \$250,000, respectively, to operate. Excluding these grants, operating losses were recorded in both years, (Table 4.3). Income tripled in 2001 compared with the previous year, largely due to a rise in income from radio and other sources (Figure 4.4). However, gains were more than offset by higher operating costs. Wages increased by 49%, and telecom costs rose significantly, (Table 4.4).

**Table 4.3: Tuvalu Media Corporation Financial Summary, 2000 and 2001**

Item	2000	2001
Net income	41,510	133,225
Expenses	232,954	343,419
Operating profit/loss	(191,445)	(210,194)
Government grant	234,750	250,000
Net profit	43,305	39,806

Source: TMC accounts.



Source: TMC accounts.

TMC's 2002 budget predicts total operating income of around \$200,000 and expenditure of \$485,928. However, the latter includes depreciation of fixed assets (\$104,066), which were omitted from the 2000 and 2001 statements. Part of the 2002 revenue shortfall is to be met by a third government grant of \$100,000. There is need for greater financial self-reliance as underlined by 20% of TMC's 2002 income exclusive of the grant being expected from its printing services. These largely involve photocopying and binding services for government departments and the public. Constructing and equipping the new government administration block in 2003 is likely to decrease the Government's reliance on these TMC services.

It is important, therefore, that the Corporation offset future revenue shortfalls by improving and expanding its broadcasting services; an area it monopolizes. Examining broadcasting operations in other small Pacific islands would help. In Niue, for example, a private broadcaster once successfully ran a TV cable network. Using "free-to-air" programs interspersed with nightly local news, the Niue operator derived income from advertising fees paid by local companies and monthly cable charges to subscribers. TV services in Niue have now been

**Table 4.4: TMC Operating Expenditure, 2000 and 2001**  
(\$)

Item	2000	2001
Audit fee	465	0
Bank charges	70	253
Board expenses	4340	5318
Customs, freight	4863	4959
Wages	149291	222938
Hire charges	1275	659
Hospitality	139	181
Maintenance bldgs.	17738	7239
Maintenance car	1205	1219
Administration	3266	10580
Utilities	27205	48647
Replacements	15501	4064
Staff development	3634	7906
Consultancies	859	4086
Subscriptions	205	178
Telecom	2891	25183
<b>Total</b>	<b>232947</b>	<b>343410</b>

Source: TMS accounts.

corporatized and income is derived from a flat-rate license fee levied on all television receivers. With its larger population, the market demand for such services in Funafuti would appear to be much greater than in Niue. Currently, television broadcasting is limited to one night per week in Funafuti where prerecorded local events such as local dances (fatele) are shown. Foreign free-to-air programs were broadcast in Tuvalu briefly in the mid-1990s, but ceased in 1998 when receiver equipment failed. Attempts to repair the equipment have been unsuccessful.

The **Tuvalu Philatelic Bureau** (TPB) was established soon after independence in 1978 and for its first few years was the country's major foreign exchange earner. In a buoyant world market, international demand for Tuvalu stamps was fueled by the quality of the stamps issued, with Tuvalu gaining the distinction of being "the No.1 in the world of philately" (UK Stamp Catalogue & Stanley Gibbons Stamp Catalogue – 1977-1979). TPB was the country's third largest employer for a few years, but by the mid-1980s its fortunes had changed dramatically. Faced with a recurrent budget deficit caused by a decrease in British grants and a severe downturn in the global philatelic market, and acting against the advice of TPB management, the Government launched the so-called "Leaders of the World" issue in an attempt to shore up sales and offset the impending budget shortfall. This issue, depicting famous foreign football players, trains, aircraft, and so on, did not receive market acceptance. Instead it caused a sharp fall in demand for Tuvalu stamps. 'Leaders of the World' was soon abandoned, but the experience severely dented market confidence in Tuvalu's stamps for more than a decade. Only recently have TPB sales recovered.

Table 4.5 summarizes TPB performance from 1996 to 2001. Accounts for 1998 to 2000 remain unaudited, but the figures show a disappointing profit history, with some improvement towards the end of the period. Current assets remained under one third of current liabilities throughout; and at the end of 1999 accumulated losses were almost \$739,000. In late 2000, the Auditor General observed that TPB was "in such a poor financial position that it should be closed" (Audit Office 2001).

If TPB is to trade out of financial difficulty, there is need to continue improving gross profits by

- (i) increasing market share;
- (ii) reducing sales returns and production costs; and
- (iii) containing operating expenses, particularly a wages bill that increased 59% between 1997 and 2001.

This need is recognized in TPB's corporate plan for 2002 to 2004, which has adopted a conservative policy of limiting stamp issues to between six and eight per year, while seeking to capture more market share by penetrating the Asian market and by developing a TPB website. The plan also envisages amalgamating TPB with the Post Office to reduce production costs and operating expenses.

Table 4.5: TPB Financial Summary, 1996 – 2001

(\$)

Item	1996	1997	1998	1999	2000	2001 (est.)
Sales	282,274	469,079	390,432	243,901	400,700	395,800
Gross profit	125,150	153,218	102,337	92,562	246,974	255,800
Operating expenses	269,640	87,438	105,235	115,823	138,780	149,703
Net profit, loss	(165,596)	62,965	(12,555)	(23,189)	108,274	106,497

Source: TPB Accounts

The **Vaiaku Lagi Hotel** (VLH) has been owned and run by the Government since independence. Rebuilt in 1993, it is Tuvalu's main hotel and is used extensively to accommodate foreign officials, hold national and regional workshops, and to host government functions. Corporatizing VLH in 1988 has not changed significantly the way it is governed or managed. As with the other public corporations, management is appointed by a board of directors that the minister appoints. Invariably the chairperson is the permanent secretary of the responsible ministry. Employment conditions for hotel employees mirror those of government workers.

VLH accounts up to 1998 have been audited. It reported losses in all years between 1995 and 1998, even allowing for the inclusion of government grants of \$50,000 in 1995 and 1996 as income (Table 4.6). Depreciation costs (Table 4.6) were a substantial component of expenses, while bad debt write-offs increased significantly (Figure 4.7), accounting

for some 47% of losses in 1998. Wages, telecom, and electricity costs remained relatively constant or fell over the four years (Figure 4.7). Poor management was reflected in a 1998 loss of \$58,000 in VLH's beverage department, where substantial stock was missing. There is little evidence of managerial or financial improvement since 1998.

Since the early 1980s, the Government has considered a management contract with a private sector manager, to improve returns on its investment in VLH. Such a contract could be

- (i) a lease (where the Government would receive a fixed rent);
- (ii) a concession (where the Government would be responsible for fixed investments); or
- (iii) a joint venture (where the private sector manager owns part of the equity).

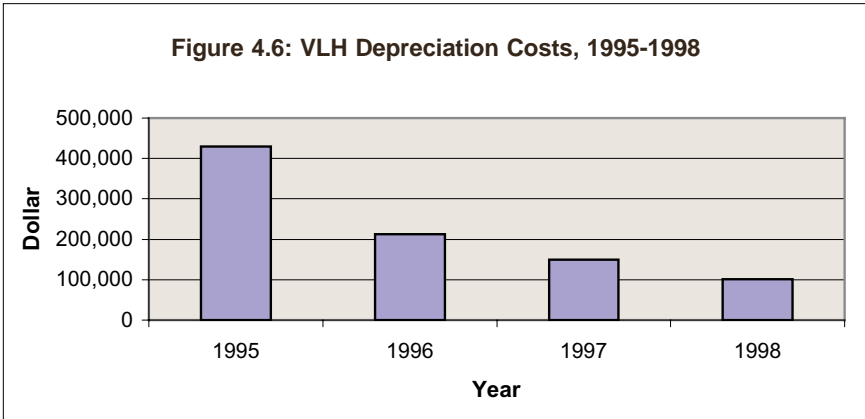
The Government hesitates, perhaps because it could lose control of an asset it uses extensively for official purposes. However, given the state of VLH finances and management, the Government should seriously consider a management contract, noting that it must have the capacity to prepare, monitor, and enforce the contract.

**Table 4.6: VLH Financial Summary, 1995—1998**

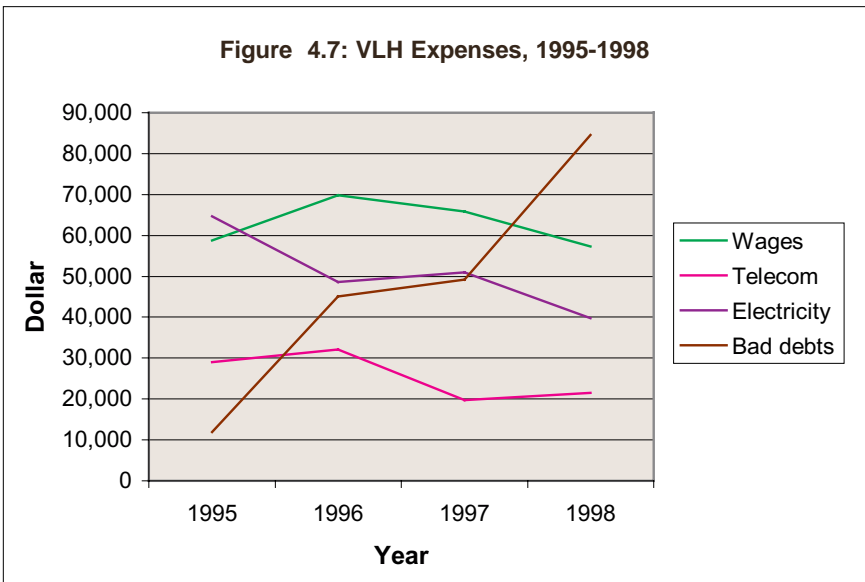
(\$)

	1995	1996	1997	1998
Revenue	315,277	288,562	361,600	191,948
Expenses	642,203	489,384	400,870	369,230
Profit, loss	(326,926)	(200,822)	(39,270)	(177,282)

Source: VLH accounts 1995-98 (audited).



Source: VLH accounts 1995-98 (audited).



Source: VLH accounts 1995-98 (audited).

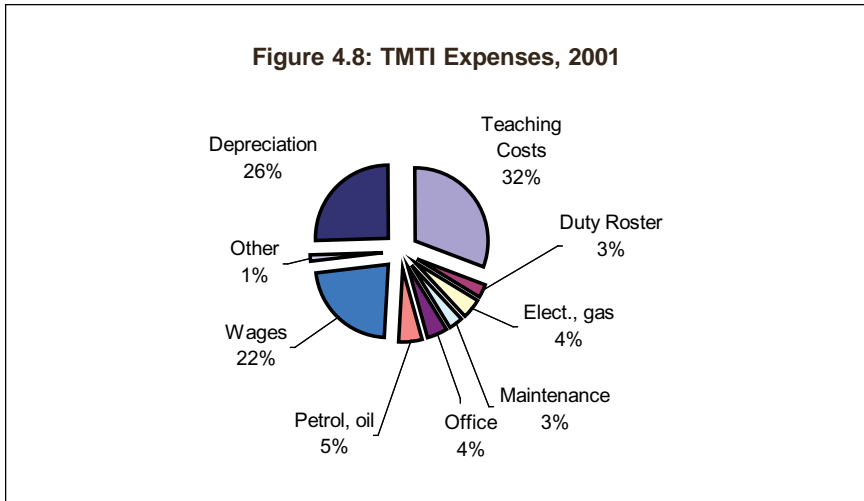
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The **Tuvalu Maritime Training Institute** (TMTI) was the Maritime School, a division of the Ministry of Education, Sports and Culture (MESC) from independence until mid-2000, when it was corporatized by an Act and changed its name. TMTI's mission is to provide "quality training for seafarers at all levels to enhance their employment opportunities in the maritime industry" (TMTI 2001). The training activities and outcomes are examined in Chapter 5. In general, TMTI operates a quality control system approved to International Maritime Organization standards.

A board of directors oversees TMTI's operations: it consists of the chief executive officer, two employer representatives, a representative of the Tuvalu Overseas Seamen's Union, a public servant, and a community leader from Funafuti. The Board reports through the secretary of education and culture to the minister of education and culture. It appears that corporatization has involved little more than the name change, and that TMTI still operates as a division of the ministry, with a commensurate degree of ministerial involvement in daily operations.

TMTI's accounts for its first year (2001) report a net surplus of \$91,197; but 98% of that was from a government grant, with course fees accounting for just 0.9%. Large annual government cash injections are expected to continue, with the 2002 national budget providing a subsidy of \$300,000 and a special development expenditure of \$200,000 on a submarine cable to Amatuku (the TMTI site). Upgrading TMTI facilities is to be funded by an Asian Development Bank (ADB) loan, arranged in early 2002. Figure 4.8 shows the breakdown of TMTI expenses in 2001.

Given the importance to Tuvalu of income from overseas maritime employment (chapters 2 and 7), it is crucial that TMTI training and facilities be maintained to required international standards. The TMTI Quality Control Manual expressly sets out the policies and procedures for such compliance; and the Government and external development assistance agencies have indicated their willingness to provide ongoing funding. Consideration could be given to increasing the degree of cost recovery through fees, especially from seamen receiving in-service training.



Source: TMTI accounts, 2001.

## The Transport Sector

**Domestic shipping** services in Tuvalu were provided entirely by the government-owned *Nivaga II* until early 2002. In 2000, a privately-owned ship began operating in the interisland trade, but services soon ceased because the vessel sank. In March 2002, Japan donated, the *Manu Folau*. This 46.5-meter vessel was built specifically to transport cargo and up to 160 passengers. It will complement services provided by the *Nivaga*, in particular improving the frequency of visits to outer islands, and freight and passenger lifting from Suva. Like the *Nivaga*, the Government will run the *Manu Folau* through the Marine Division of the Ministry of Works, Communications and Transport. It appears the Government has not estimated the impact of running the new vessel on the Ministry's recurrent budget.

Various proposals for commercializing, corporatizing, and privatizing domestic shipping services have been discussed. Most

recently, the Government considered retaining the majority shareholding of a proposed limited liability company, with the remaining shares being offered to the public. The local governments (kaupules) were considered potential investors in the "Tuvalu Shipping Proprietary Limited," but community responses to initial approaches were not positive. A memo of incorporation and articles of association of the proposed company were drafted but no bill was ever brought to Parliament. The total share value of the proposed company was set at \$3 million with 3,000 shares at \$100 each. The *Nivaga II* was to be the main asset, valued at \$1,430,630 and the Government was to retain 14,306 shares (the value of the *Nivaga*). The maximum number of shareholders would have been limited to 20 with a minimum of three. However, the Government has not proceeded to create the company.

Island communities' reluctance to invest in shipping is not surprising, given the financial results of *Nivaga* operations. From 1996 to 2001, the *Nivaga* recorded a surplus only in 1996 (Table 4.7). Since 1996, substantial losses have been made. The huge loss of \$3.7 million in 2000 was largely from renovating the ship. Such costs had been estimated at around \$300,000 before slippage, but escalated quickly once the ship was dry-docked in New Zealand. The absence of a detailed cost estimate, plan of work, and executable contract with the repairers was unfortunate and left the Government vulnerable.

**Table 4.7: Nivaga Financial Summary, 1996—2001**

(\$)

Item	1996	1997	1998	1999	2000	2001
Income	670,117	603,045	409,452	301,553	337,647	667,000
Expenses	116,349	835,270	966,612	827,961	4,110,862	1,700,000
Profit, loss	553,768	(232,225)	(557,160)	(526,408)	(3,773,215)	(1,033,000)

Source: MFEP, Treasury Accounts.

Freight rates and passenger fares are well below the levels that would permit *Nivaga* operations to break even, leaving aside depreciation expenses (ADB 1998). Continued subsidies seem inevitable, even if domestic shipping were privatized, and can be defended on equity grounds. Similar equity considerations lay behind introducing the Import Levy (Special Fund) Act 1997, which allows disbursements from the Fund "to finance or assist to finance the transportation by ship within Tuvalu of goods in respect of which the import levy has been paid." Effectively the Act equalizes consumer prices within Tuvalu, meaning that consumers purchasing goods in Funafuti subsidize freight charges to the outer islands. Prior to the Act, the Tuvalu Cooperative Society had achieved much the same result by applying a freight equalization markup on all goods imported, ensuring that its retail prices remained the same on each island irrespective of interisland freight rates. The Act extended this concept to all importers and traders.

The real issue for domestic shipping is if Government subsidies are transparent and justified by the quality of service provision they support. The national budget identifies "upgrading of shipping services" as a key output of the Marine Department of the Ministry of Works, and lists program activities and performance indicators. A first step in making shipping operations more accountable would be for the Ministry to review the appropriateness of these indicators, to monitor activities, and report on results.

**International air services** consist of flights to and from the Fiji Islands twice weekly by Air Fiji. The Government of Tuvalu is the largest single shareholder in the latter company following its 2001 purchase of the Ah Koy family share in the holding company, Aviation Investments Limited. This investment turned out to be risky, as the TTF Advisory Committee reported in April 2002:

*A year ago the Committee expressed concern about deficiencies in the Government's 'due diligence' preparation for its investment in Air Fiji. That concern has turned out to be well founded. Tuvalu has only now become aware of the depth of mistrust and*

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*ill feeling between the Ah Koy family and CATIC, the two shareholders who jointly controlled Air Fiji through the holding company Aviation Investments Limited (AIL) until the Ah Koys sold their shares in AIL to Tuvalu. As part of the sale agreement Tuvalu undertook to keep an Ah Koy nominee on the board of Air Fiji indefinitely. The bitter dispute between the Ah Koys and CATIC, which goes back several years, was concealed from Tuvalu by both Ah Koy and CATIC until very recently. This hostility is handicapping Air Fiji's commercial viability, and seems unlikely to end until either the Ah Koy family or CATIC are no longer involved.*

*To extricate Air Fiji and itself from this risky situation the Government will have to be particularly clear-minded and astute (TTF Advisory Committee 2002, p.27)*

The TTF Advisory Committee went on to recommend working with the Government of the Fiji Islands (also a shareholder of Air Fiji) to ensure the airline's competent technical and commercial management.

## Conclusion

It was noted at the beginning of this Chapter that necessary conditions for successful corporatization included

- (i) clarity of objectives and roles to be played by ministers, boards, and general managers;
- (ii) management autonomy and authority; and
- (iii) strict accountability for performance.

The fourth condition of competitive neutrality is less relevant in the Tuvalu context because of the extremely small markets. This Chapter's review of operations by the 10 public enterprises has shown that these conditions have not been met generally. This is although efforts have been made, beginning with

- (i) the Amatuku retreat of August 1997 (GOT 1997b, 1997c);
- (ii) the continuing externally-provided advice and training on corporate planning; and
- (iii) the drafting of a service-operating agreement for TTC.

Lack of accountability is the most conspicuous weakness in the corporate governance environment, and reflects a failure to act under legislation that requires timely annual reports and financial accounts. In the absence of information, the small Public Sector Reform Unit in OPM has been unable to monitor and report. Also the Government continues to provide substantial financial support to the public enterprise sector, while only assuming its shareholder interests are adequately protected (in markets where there are no competitive pressures to perform).

Lack of accountability in the public enterprise sector partly reflects two types of capacity constraint:

- (i) the shortage of qualified and experienced board members who are not current or former government employees, and who can exercise the control function without being captured by public enterprise management; and
- (ii) the shortage of qualified accountants to operate a functioning accounting system that generates information for sound decision-making, internal and external auditing, and financial performance monitoring.

Corporatization increases the demand for board members and accountants and will not succeed unless there is a supply-side response that significantly eases these constraints. As the Auditor General has observed: "Every new corporation that is created will require accounting staff. The Government should cease its program of creating new corporations until the problems within current corporations are under control" (Tuvalu Audit Office 2001). The practicality of corporatization under Tuvalu's current circumstances remains to be established.