Restricted Collection

Institute of National Affairs

Discussion Paper No1

Foreign Investment Policy

August 1977

INSTITUTE OF NATIONAL AFFAIRS

P.O. Box 3530

Port Moresby

PAPUA NEW GUINEA

Director of Research: T.J. Pitt

THIS DOCUMENT CONTAINS THE FINDINGS OF THE FIRST RESEARCH PROJECT UNDERTAKEN BY THE INSTITUTE OF NATIONAL AFFAIRS THE PURPOSE OF THE PROJECT IS TO IMPROVE DIALOGUE BETWEEN THE GOVERNMENT AND THE PRIVATE SECTOR PARTICULARLY IN POLICY AREAS OF MUTUAL INTEREST

TABLE OF CONTENTS

A SURVEY OF FOREIGN INVESTMENT IN PAPUA NEW GUINEA

John Wylie,
April,1977

A C K N O W L E D G E M E N T

This paper has been written for the Institute of National Affairs with a view to fostering constructive dialogue between the public and private sectors of the Papua New Guinea economy. I am grateful to those people who, by commenting on an earlier draft, prompted its improvement.

C O N T E N T S

PART ONE

PAPUA NEW GUINEA’S FOREIGN INVESTMENT POLICY

PART TWO

THE ADVANTAGES AND DISADVANTAGES OF FOREIGN INVESTMENT IN PAPUA NEW GUINEA : REVIEW OF THE THEORY

PART ONE

PAPUA NEW GUINEA'S FOREIGN INVESTMENT POLICY

Introduction

During 1976, two major planning documents were written by the Papua New Guinea government. The National Development Strategy reaffirmed the government's dominant role in the country's development and gave a general indication of government aspirations with respect to the direction and nature of this development; and the National Investment Strategy discussed the role to be played by the private sector in this development.

The overriding objective of the National Development Strategy was the creation of a livelihood for as many people as possible. This paper started from the proposition that the urban centres cannot hope to cater for more than a small proportion of the country's total population. It therefore argued against a development strategy based on subsidising urban industry with a view to creating wage employment. In this strategy it was claimed that even with massive subsidies or tariffs, there could only be a slow expansion of wage employment. From this basis it was concluded that the government's development programme should concentrate on generating opportunities for self employment in the rural sector.(1)

This broad approach to development does not constitute a rejection of modern private enterprise, in fact the National Investment Strategy is based on the premise that the private sector can contribute to the country's development objectives and in certain instances may be the best way of doing so.(2) However because national firms at present lack the capital and expertise necessary to undertake certain developments required by the government, future development of the country's industrial and resource base will be largely dependent on foreign investment.

Historically, foreign investment has been a dominant force in Papua New Guinea's development, and for as long as the country remained an Australian colony, a loosely defined foreign investment policy encouraged investment in keeping with an overall emphasis on economic growth.(3) However after its election, in mid 1972 the Somare government moved to define a more nationalistic foreign investment policy. Foreign investment was declared politically acceptable by this new government, although the earlier "open door" approach was rejected in favour of selectivity whereby foreign proposals to invest in the country were to be subject to government scrutiny and rejected or modified if found to be "undesirable". Certain activities were now made inaccessible to foreign investment, and those acceptable investment proposals were to be admitted subject to the investor fulfilling certain government imposed conditions relating to such matters as local equity, training, and ancillary ventures.

The decision to establish clearer guidelines regarding foreign investment was reflected in legislation introduced to parliament in 1974. The National Investment and Development Act provided for the regulation, control and promotion of investment in the "interests of national development". To this end it established the National Investment and Development Authority (NIDA) to serve as the body responsible for implementing government policy on foreign investment.

Since the establishment of NIDA, the government has made considerable progress towards defining its policies on foreign investment in various sectors of the economy. Broad guidelines for prospective investors are outlined in a number of policy documents which are footnoted in the following paragraphs. The following brief statement of policy discusses three sectors of the economyextractive industry; agriculture production; and manufacturing and service industry.

(a) Extractive Industry:Proceeds from the commercial exploitation of the country’s natural resources are needed to finance development in other sectors of the economy.It has been argued that Papua New Guinea’s eventual economic self reliance will be achieved as a result of the extraction of her natural resources.(4)The taxation and royalty payments associated with extractive developments are the most likely means of generating the government revenue needed to sustain rural development.

In its third National Investment Priorities Schedule, NIDA identified a number of specific mineral, petroleum, forestry, and fishing projects for development. This enclave development is to be achieved by predominantly private sector activity because the government wishes to avoid using its own limited resources on such undertakings.(5)Given that national firms lack the resources necessary for major enclave projects, large scale foreign investment is required for this development (although permission to exploit these natural resources is to be limited to the government’s anticipated revenue and foreign exchange requirements.)(6)

While foreign investments operating in the extractive sector will be allowed the opportunity to earn a “reasonable” and remittable profit on their investment, the bulk of profits earned in excess of normal industry profits are to go to the government through taxation. This mechanism is designed to enable the country to retain a substantial share of the exploitable value of her resources, even when fluctuations in world commodity prices give rise to unusually high profits.It is a stance which is justified on the grounds that the country’s natural resources belong to Papua New Guinea and so the government rather than the foreign investor is to be the main beneficiary of their exploitation. (7)

Although the specific terms and conditions for individual enclave projects are to be subject to negotiation between the potential investor and the government, the following guidelines are generally applicable . Foreign investors are expected to raise their capital requirements from outside Papua New Guinea and as far as possible procure their other inputs from within Papua New Guinea;the developer rather than the government is to pay for any required infrastructure; developers are to incur reasonable cost to minimize environmental damage, agree to staff training and localisation requirements, agree to national equity participation, and agree to provide assistance for related local industries;developers are also to demonstrate export marketing ability, and must proceed with developing the project as rapidly as possible. They are also expected to lodge a performance bond with the government.(8)

(b) Agricultural Production: Foreign involvement in agricultural production (both import replacement and export oriented) is sought where it provides inputs not otherwise readily available to Papua New Guinea. These desired inputs include capital, modern technology, processing facilities, and both marketing and management services. Foreign investment is required in relatively large scale operations, with the emphasis on nucleus estates and joint ventures.It is envisaged that these projects will be required for the production of sugar, palm oil, legume and grain crops, and tea.(9) Those guidelines specified for extractive industry are also generally applicable to foreign investment in agriculture.

(c) Manufacturing and Service Industry: The government has yet to adequately clarify its policy towards foreign investment in manufacturing and service industry (e.g. tourism, construction, transport, and commercial services). This sector rates only passing comment in the Third National Investment Priorities Schedule, and only vague preferences have been expressed in the other foreign investment policy documents.

Stated policy seeks foreign investment for the development of both export-oriented and import-replacement manufacturing, as well as for the development of service industry necessary to encourage and sustain growth in other sectors of the economy.It is envisaged that foreign manufacturing operations will provide inputs to the agricultural and extractive sectors; further process agriculture and extractive produce;and produce consumer goods for local demand.(10)

Because of the country's comparatively small domestic market, the establishment of manufacturing operations capable of supplying both the domestic and export markets seems an appropriate form of development. This possibility has become very much more realistic since the signing of a long term trade and commercial agreement between Australia and Papua New Guinea in November 1976.This agreement generally provides for Papua New Guinea exports to have non reciprocal free access to Australian markets, and thereby gives some scope for Australian manufacturers to reduce overall costs by relocating to Papua New Guinea and servicing their existing market through export arrangements.(11)

In addition to its power to decide what foreign manufacturing and service industries will be allowed in Papua New Guinea, the government has expressed an interest in influencing the pattern of industrial development through the choice of ownership structure, technology and geographic location.(12)The scope of this proposed intervention has yet to be clarified.

The government expects foreign investors to be efficient by world standards. This implies that they must be capable of survival without long term government assistance, and in the case of import-replacement industry, provide goods and services for local consumption at prices no higher than those of imported substitutes.(13)Those guidelines specified for extractive industry are also generally applicable to manufacturing and service industry.

The fact that Papua New Guinea has clearly defined its policy towards foreign investment in the extractive and agricultural sectors, but has yet to clarify its policy in the manufacturing and service sector is to some extent understandable in view of the comparatively recent establishment of NIDA and its early work priorities. Government dealings with foreign investment which involves the extraction of Papua New Guinea's non-renewable resource endowments should entail a somewhat different approach to its dealings with foreign investors contemplating manufacturing, tourism, commercial services, or infrastructure activities. Where foreign investment involves an extraction of natural resources, there is a danger that the country will sell its resources for less than they are worth, particularly so if the national interests are not properly represented.so that a reasonable balance of negotiating power is maintained between the government and the foreign investor. It follows that the risk of loss to Papua New Guinea is very much greater in the case of foreign extractive industry than in other cases of foreign investment.

To the extent that this is so, the fact that Papua New Guinea considered a clear definition of policy towards non extractive foreign investment to be less important than the definition of policy towards extractive foreign investment, can be justified. However the uncertainity with respect to policy towards foreign manufacturing and service ventures has damaged the country's investment climate because it eroded the confidence of existing foreign investors, many of whom are engaged in non extractive activities. This points to an urgent need for further work to be undertaken in clarifying policy matters relating to non extractive foreign investment.

If Papua New Guinea is to maximise the potential advantages and minimise the potential disadvantages associated with foreign investment, it should implement carefully formulated policy measures which will ensure that investors are still attracted to the country despite the fact that they are subject to government regulation and control.This implies the need for foreign investment policy which not only safeguards the national interest, but also provides a favourable investment climate. Such policy should balance the need for sensible rules attuned to changing circumstances against the need for policy which is sufficiently stable to allow investors to plan for the medium to long term.

Considerations relevant to host country policy on foreign investment include the investment climate, incentives given to attract investors, the control and regulation of investors, and the administration of the policy.The following review of Papua New Guinea's foreign investment policy contains comments on each of these considerations.

2. The Investment Climate

A potential investor will be encouraged to invest in a favourable investment climate (i.e. one where there is a perceived potential for adequate profits together with prospects of only moderate risk and obstruction).In view of Papua New Guinea's favourable resource endowments and growing domestic markets, the profit potential from certain investments appears quite high. Despite this potential for profitable enterprise, foreign investment will not be forthcoming unless the risk and obstruction is considered acceptable by the investor. The more risky and difficult a proposed venture, the greater the return on investment will have to be in order to entice an investment. A country's government is capable of influencing its investment climate in the following areas:

(a) By demonstrating sound management of the national economy: In this regard the Somare Government has established an excellent record. The central considerations in the country's responsible economic management have been restricting national expenditure to levels which the country can afford, maintaining the kina as a "hard currency" and insulating the economy from the destablising influences of fluctuations in the world economy.(14)

The central theme of the 1976 World Bank Report was the need to bring the country's administration and living standards into better relationship with what can be sustained from Papua New Guinea's own resources.Papua New Guinea has adopted two approaches to budgeting government expenditure closer to what the country can afford.Firstly, additional domestic revenue has been raisedby imposing a heavier tax burden.Initially this involved "taking up the slack" in taxing the existing tax base. Now that this has been achieved, there is a further need to expand the tax base to cover those self employed cash earners who are not taxed effectively. Secondly, non priority government expenditure has been restricted, and some tentative moves made to re-orient this expenditure from social and administrative services to developmental investments.

The Government is also committed to a so-called "hard currency" strategy. This implies national wage restraint and tight control over budget deficits so that the level of imports is kept to within a manageable level so that devaluation can be avoided.Given that Papua New Guinea has one of the highest propensities-to-import of any country in the world, devaluation would be highly inflationary and so generate pressures for compensatory wage increases. The government wishes to avoid the scenario of deficit balance of payments, devaluation, inflation, wage increases, deficit financing of the government budget, and so renewed deficit balance of payments. The government approach to the country's balance of payments centres on its management of aggregate demand by restricting its own spending and combating further wage escalations, thereby restricting the country's level of imports.

Price control is seen as a necessary complement to the policy of wage restraint. However, the administration of existing price control measures has been poor as a result of the authorities' failure to hand down a decision on a proposed price rise within a reasonable period.(15)

Because Papua New Guinea has opted for an "open" economy in which organisations are allowed to import and export with a minimum of controls, and in which foreign capital flows are generally approved, the economy is particularly vulnerable to external events. As a result of this inherent instability, the government has established a number of stabilisation funds which enable its revenue flows, and so its expenditure levels, to be less responsive to fluctuations in world commodity and metal prices.(16)

(b) By demonstrating sound foreign investment policy .The brief outline of Papua New Guinea's foreign investment policy as set down on pages 3 to 5 indicates that this policy is basically sound. However there have been some unfortunate aspects associated with the implementation of this revised foreign investment policy which have damaged the country's investment climate.

Prior to the creation of NIDA, there was considerable public debate over the role which foreign investment was to play in an independent Papua New Guinea.This debate, which came at a time of rapid political development encompassing Self Government and the prospects of Independence, contributed to an erosion of business confidence.

The National Investment and Development Act, together with NIDA's initially aggressive approach to publicity, heightened unjustified fears of nationalisation, of the provision for heavy penalties associated with the new requirements, and of government access to otherwise confidential information. This fear was accentuated by some poorly conducted negotiations between NIDA and prospective foreign investors, and by NIDA's failure to properly explain its activities to the private sector,(17) Furthermore, the official foreign investment policy was left unclarified so that uncertainity with respect to this policy acted as a disincentive to investment.(18)

The renegotiation of the Bougainville Copper Agreement, while possible legitimate in terms of providing Papua New Guinea with a more reasonable share of the mining proceeds, cast some doubts on the government's integrity in abiding by agreements with foreign investors. Thus the renegotiation probably damaged the country's investment climate even though it was argued that the former agreement was made by the Australian administration and was therefore not binding to a Self Governing Papua New Guinea.

These difficulties arose largely as a result of the lack of effective communication between the government and the private sector. Recently there have been indications that more constructive dialogue is developing between these two sectors. A number of government offices have begun approaching various private sector organisations for comment on official policy deliberations, and the business community is organising itself towards making more constructive comment based on professional research.

(c) By minimizing the bureaucratic obstruction to foreign investment: one justification for having a body such as NIDA is that it can streamline the bureaucratic process involved in government dealings with foreign investors. However in Papua New Guinea, a foreign investor's application is evaluated by the NIDA board which comprises the Department Heads of all the major government ministeries concerned with foreign investment.Because these board members are briefed by both their departmental staff and the NIDA secretariat, it can be argued that NIDA represents an extension of the bureaucratic procedures associated with investing in the country.

In addition to being screened by NIDA, most foreign investors require clearance from a number of other government authorities.For example those investors contemplating foreign exchange transactions require authority from the Bank of Papua New Guinea. Authority to acquire land necessitates a cumbersome tender process involving both the Land Board and the Department of Natural Resources.Permission to erect a building requires approval from the local Council Building Authority, the office of Environment and Conservation, and the Department of Public Health.

While checks such as these are undoubtedly necessary to safeguard the interests of Papua New Guinea, it is probable that they could be streamlined without compromising their effectiveness. Any reduction in the official obstruction to investment will make the country more attractive to investors. Provided NIDA upgrades the professional quality of its secretariat, there could be considerable advantage in extending its powers in order to facilitate its stated co-ordination role.

(d) By safeguarding the interests of foreign investors:In Papua New Guinea, this is attempted by official guarantees which are documented in the National Investment and Development Act. These guarantees cover freedom from nationalisation and expropriation except under exceptional circumstances to be defined by law (and under such circumstances compensation shall be paid); the right to remit profits and foreign capital together with any principal, interest or service charges liable on foreign loans; and non discrimination in rates, taxes, rents, tariffs and duties. (19)

While it is recognised that no government can effectively bind its successors to an established course of action, some effort should be made to strengthen the guarantees presently offered so that they at least conform with the international norms of prompt and adequate compensation upon nationalisation. The guarantees should include some discussion as to what constitutes "exceptional circumstances" under which nationalization is permissible and as to the criteria to be used in calculating the compensation payable as a result of nationalisation.There should also be an undertaking to pay the compensation within a specified period after the nationalision.

Non-discrimination in taxation should not appear as one of the guarantees because, in the light of the five year tax holiday for national firms and of the dividend withholding tax, it constitutes a breach of guarantee on the part of government.

The fact that the qovernment states that it will retain ultimate authority in any conflict of interest between itself and foreign enterprise is understandable because any other arrangement would constitute an enfringement of national sovereignty, and could not, in any case, be enforced.(20) Despite these practicalities, it could bolster business confidence if Papua New Guinea were to sign the Convention on Settlement of Investment Disputes which has been drawn up under the auspices of the World Bank. Such action would be in keeping with the government's obligation (under Article 8 of the International Monetary Fund) to ensure the availability of foreign exchange to private investors in order to enable them to meet any financial commitment associated with their Papua New Guinea business.(21)

3. Incentives Given to Attract Foreign Investment

Investment incentives are instruments of government policy which are designed to induce new private investment or stimulate expansion of existing private investment. Such incentives can be justified only where they promote desirable investment which would otherwise be not forthcoming. Thus care needs to be exercised in the granting of investment incentives because of the possibility that they will merely confer windfall benefits to investors who would have made the investment without the added impetus of the incentive. In commenting on the use of investment incentives in Papua New Guinea, reference will be made to both fiscal and information incentives.

Fiscal incentives include such measures as tariff protection, tax holidays investment allowances, and subsidies which may take the form of a direct grant of government funds, or the provision of infrastructure such as industrial estates or transport facilities at concessional cost to the investor.

In all cases the country incurs direct costs.Tariffs are to the detriment of national consumers, while the other fiscal incentives impose costs in terms of an expenditure of scarce public funds or forgone taxation revenue. It follows that a rational system of fiscal investment incentives should be based on an evaluation of the benefits (in terms of induced investment) and costs as discussed above. Should such an evaluation be carried out, it would probably reveal that assistance is justified only during the early years of a project, and then only if it enables an otherwise unviable operation to reach profitable maturity.

This points to a need for flexible incentives rather than ones which,having once been granted, prove to be politically difficult to discontinue.In view of this consideration, the best type of incentive from the government’s viewpoint is the direct subsidy. Because these subsidies appear in the national budget, they are subject to open scrutiny, so that all interested parties can ascertain the cost of assistance provided to investors each year. Furthermore the cost of subsidies is generally more equitable than the cost of tariffs because low income earners with small tax contributions would pay little towards subsidising an industry;whereas they might well pay a lot to support that industry if they consume its products and it is protected by a tariff which prevents them from consuming less expensive, imported substitutes.

Papua New Guinea has chosen to provide minimal fiscal incentives to foreign investors, although stated policy does recognise a need to divert some government funds to assist the development of the private sector.(22) In 1970/71 approximately 10% of the country’s secondary industry was directly dependent on tariffs or other forms of protection. The protection enjoyed by manufacturing industry is largely by way of tariffs, although tax holiday incentives were available to foreign investors under the Pioneer Industries Scheme from 1965 to 1973.The weighted average effective rate of protection in Papua New Guinea during 1970/71 was 26%.However muchof this protection appears to have been granted on an ad hoc basis with levels of effective protection ranging from 2% on clothing to 480% on tobacco.(23)

Because the domestic costs of production and distribution are likely to be higher than the landed costs of many imports, import substitution in Papua New Guinea is likely to proceed slowly.It is therefore important that the authorities be very selective in granting investment incentives so that permanently inefficient industry is not attracted to the country. This implies the need for careful study to identify specific viable investment opportunities within the country.

Since the establishment of NIDA, Papua New Guinea’s efforts to attract foreign investment have concentrated on promoting those investment opportunities available within the country. Investment missions have visited both Australia and Europe in an effort to market the country’s potential.Because an investor’s response to opportunity is dependent upon his awareness of that opportunity, and because Papua New Guinea is a relatively unknow country, this sales approach to attracting foreign investors is justified.

However, the existing marketing approach could be considerably improved with the provision of more factual material in support of the advertising.It has been argued that one of the most important barriers to expansion of international business is poor market information, that is the lack of information on opportunities in new markets, on the particular needs of prospective customers, on existing and future demand and supply conditions for the product in question, on existing and potential competition, on factors affecting the supply of necessary inputs, and on possible channels ofdistribution etc.(24)In view of this consideration, it is suggested that the provision of such information could provide a very effective form of incentive for foreign investors.

Such infomation could be provided at little additional cost to the country, if both NIDA and the Industrial Development Division re-oriented some of their information output from the existing emphasis on theoretical frameworks and strategies,to specific factual information on the various resource, markets and infrastructure facilities available within the country.The government needs to develop the cost, marketing and distribution data needed to identify specific projects for foreign investment.This implies gathering sufficient information to enable feasibility studies to be handed to prospective investors.Such data would be particularly valuable for the manufacturing and service sector because the required clarification of investment policy in this area can be achieved most effectively by reference to specific projects.

4. The Control and Regulation of Foreign Investment

The Papua New Guinea government has adopted a selective approach to foreign investment whereby foreign proposals to invest in the country are subject to its scrutiny and may be rejected or modified if found to be “undesirable”. In effect, NIDA wants to determine beforehand those industries which will be open to foreign investment and to publicise its findings in the National

Investment Priorities Schedule. In view of the possible disadvantages associated with foreign investment, this selective approach appears justified.

In being selective, NIDA aims at channelling investment into those activities where the best use is made of the country’s resources.(25) This implies clearly specified national objectives together with their respective priorities. A major difficulty associated with Papua New Guinea’s investment policy has been the lack of a clear definition of “the national interest”.Given the nature of the country’s political process, it is probably unreasonable to expect that there will ever be any clear specification as to whether the country will be “best” served by investment which generates employment, stimulates income, earns foreign exchange, achieves some other goal or some specific combination of goals. There are twenty-three investment guidelines which have been drawn up as part of the National Investment and Development Act.However these guidelines do not constitute a set of specific criteria for the evaluation of investment proposals. Rather they form a loosely defined, and at times contradicatory, framework of principles within which NIDA and the foreign investor can negotiate an agreement.(26)This means that NIDA has been given little guidance as to what specific attributes will result in an investment proposal being classified as “undesirable”.

Rather than first clarifying a set of pragmatic criteria for its own use, NIDA immediately involved itself with the practical problems of screening foreign investment proposals, imposing conditions on the operation of foreign investors and formulating the National Investment Priorities Schedule. It therefore appears that NIDA envisaged implementing its control and regulatory policies in much the same way as common law, that is based on precedent within a loosely defined framework of principles.

Because the imprecise guidelines are open to varying interpretations, they provide a degree of flexibility for NIDA.Such administrative flexibility is desirable to the extent that a rigidly bureaucratic approach may well give rise to unrealistic decisions in the light of the wide variety of possible investment activities, changing economic circumstances, and possible periodic changes in national objectives. However, a flexible approach is administratively demanding because the scope for bureaucratic action is much wider and so requires a correspondingly higher level of administrative ability and integrity. There is thus a danger that manipulations within the flexible bounds set by the official guidelines will not be based on legitimate considerations, and will therefore give rise to consequences which are to the detriment of both foreign investors and the country.Sound policy will not be attainable where the by-play of national politics or personal ambitions is allowed to intrude upon thoughtful analysis of the consequences of proposed investment projects.

This points to a need for NIDA to clarify a more pragmatic set of criteria for its regulatory and control policies.Greater thought needs to be given to the problems of weighing the trade-offs between those conflicting objectives expressed in the guidelines, to the problems of evaluating a project which conforms to some guidelines well while to others poorly, and to the problems of comparing non-monetary advantages and disadvantages of various proposed projects.While it is recognised that these problems will not be neatly solved in some forthcoming policy document, there is a need for NIDA to undertake further work in this area.

Papua New Guinea needs to maintain a careful balance between exacting concessions from foreign firms and dissuading them from investment in the country. The imposition of conditions of entry aims at maximising the development effects of a particular investment proposal. Such conditions generally impose costs on the investing firm. Thus government policy on the imposition of these conditions needs to be carefully formulated so that the sum total of the requirements imposed do not render the project uneconomic for a prospective investor.

In the past, the government has imposed unreasonable conditions of entry on prospective investors.A case in point is provided by a proposed fish processing factory. Despite the fact that the investor's initial feasibility study recommended the establishment of the plant in Kavieng, government negotiators insisted that the site be Madang. A revised feasibility study for a 5000 tonnes p.a. plant was subsequently submitted to the skeleton staff of what was to become NIDA.Government negotiators then insisted that the plant capacity be raised to 15000 tonnes p.a. (thereby incurring additional financing and marketing problems for the investor). Not only did the government insist upon the venture providing its own transport infrastructure, but it insisted on a wharf designed to a larger scale than was necessary for the cannery requirements. The outcome was that, after protracted negotiations lasting some two years, the investor withdraw from the project. In this case it would appear that the government negotiators were inept to the extent that the imposition of overly ambitious conditions of entry rendered the venture uneconomic from the investor's viewpoint, and so precluded the establishment of a K6 million fish processing plant.It is doubtful whether the national benefits associated with the conditions NIDA attempted to impose on the venture could have balanced the risk of losing those benefits which the plant would have generated.

While it is recognised that this case is probably not representative of NIDA's dealings with foreign investors, it does point to the need for NIDA to exercise its powers with care, particularly so in view of the damage to business confidence which can result from poorly conducted negotiations. The more attractive the overall investment climate in any particular country, the better placed its government becomes to impose conditions of entry on firms contemplating ventures in that country.

A further consideration relevant to the imposition of conditions of entry concerns NIDA's insistance on national equity participation in foreign investments, even those small, marginally profitable ventures which are unlikely to survive the loss of their expatriate partner. In these circumstances both the national investor and the foreign investor stand to lose from the imposition.(27) In any case, the extent to which local equity participation in foreign enterprise constitutes sound policy is debatable. The motives behind this policy are likely to be a desire for Papua New Guineans to share those profits arising from investments in the country, and a desire to exert Papua New Guinea control over foreign firms. Minority equity participation is a costly and not necessarily an effective mechanism of control over foreign firms. Furthermore the profit participation associated with local equity holdings needs to be weighed against the benefits to be derived from using national savings for the development of Papua New Guinea, as distinct from foreign, enterprise.

5. Policy Administration

NIDA has overall responsibility for administering foreign investment policy in Papua New Guinea.Any foreign firm wishing to invest in the country is required to submit its proposal to NIDA for evaluation. NIDA is a statutory authority supported by a secretariat and controlled by a board comprised mainly of the bureaucratic heads of those ministeries concerned with foreign investment. Board recommendations must then be endorsed by a government Minister.Subsequent to his proposal being recommended by the NIDA board and accepted by the Minsiter, a foreign investor is granted registration which allows him to proceed with the venture.

Unlike most organisations which are controlled by a board of directors, NIDA board members are not wholly dependent on the NIDA secretariat for briefings; they also have access to their Department advisors. It follows that the NIDA board is a very powerful body relative to the NIDA secretariat. To the extent that this situation allows co-ordination of government dealings with foreign investors at the highest level of the public service, it can be defended.However it also means that there are three levels of project appraisal. This in turn may result in prolonged delay in screening investment proposals.

Each year NIDA publishes a National Investment Priorities Schedule which lists specific activities in which foreign enterprise is allowed. (28) This schedule poses administrative problems to the extent that an activity must be listed before related foreign investment proposals can be considered for registration. This situation may result in considerable delay where an otherwise acceptable investment proposal is omitted from the priorities schedule. To some extent this problem was circumvented in the second priorities schedule by the inclusion of category "H" which allowed Ministerial approval to be given to a proposed activity not otherwise covered in the schedule.The third priorities schedule further improved the situation by the inclusion of "open activities" which have not been examined in detail by the government.

This points to a basic difficulty with using a document such as the priorities schedule to inform potential investors of the government's attitude towards foreign investment in specific activities. Because the country has loosely formulated objectives and investment guidelines, the government is probably ill-advised in attempting to clearly define those activities in which it is prepared to accept foreign investment.Any specific definition may constitute a disincentive to those investors contemplating acceptable projects which happen to have been overlooked during the formulation of the priorities schedule. In view of this consideration, it is suggested that NIDA discard its existing approach of listing specific activities in which foreign investment is allowed. In it its place, NIDA should publish a schedule listing only those ventures from which foreign investment is to be excluded.Foreign investment would then be "allowed" in any other activity, but could be actively encouraged in certain activities through the provision of specific information incentives as discussed on page 14.

NIDA is required under the Act to notify by government gazette any approvals or refusals of registration, together with details of any conditions of registration.(29)For over eighteen months, NIDA failed to comply with this obligation. This meant that NIDA’s operations were not subject to public scrutiny, and as a result some fear emerged that NIDA could become corrupt in its dealings with foreign investors. Although this obligation is now being adhered to, there remains a continuing need for NIDA to keep the private sector fully informed of its activities and deliberations (within limits set by the confidentiality of potential investors).This dialogue should preempt speculations which are damaging to the country’s investment climate.

In adhering to their registration requirements, foreign investors are obliged to divulge what is otherwise confidential information. This gathering of information is a legitimate process to the extent that NIDA must be conversant with business activities undertaken in the country if it is to have a factual basis to its policy formulation. However, private firms are understandably reluctant to divulge such information. NIDA could overcome some of these objections if it were to amalgamate the individual information into broad industry profiles which could then be fed back to the private sector to assist its planning. This suggestion fits well with one of NIDA’s stated functions, viz. “to advise and assist investors or potential investors”.(30)

Existing government policy is complicated by unnecessary bureaucratic duplication. The Division of Industrial Development has responsibility for fostering manufacturing projects valued over K75,000.Its staff evaluate possible projects and plan industrial strategy, both activities being duplications of work carried out by NIDA which has the broader responsibility for all foreign investment including extractive operations. Furthermore the Department of Finance, Department of Natural Resources, the National Planning Office and the Investment Corporation all employ specialist staff to deal with foreign investment matters.There could be considerable saving of scarce resources if these functions were amalgamated into one efficiently managed instrumentality.

With the exception of a few circumstances documented in various government gazettes, all foreign enterprises earning a gross income of more than K4,000 p.a. must register with NIDA.(31) In view of the limited resources available to the NIDA secretariat, the pressing need for it to clarify some important aspects of investment policy, and the need for it to provide specific information on those important projects requiring development by foreign investment, it would appear that NIDA spends a disproportionate amount of its resources on registering insignificant enterprises.Given that the potential loss to Papua New Guinea from small scale foreign investment acceptable under the priorities schedule would be minimal only those foreign firms earning a gross income of say K100,000 should require registration, although smaller foreign firms should still be obligated to notify NIDA of their activities.

Official policy statements have so far made only brief reference to the intended involvement of Provincial Governments in foreign investment negotiations. (32)Unless this involvement is carefully controlled, a situation could arise whereby foreign investors are able to “play off” the Provinces one against the other in order to obtain the best possible deal from the investor’s viewpoint (a deal unlikely to be the best from the national viewpoint), Furthermore, involvement of Provincial Governments in foreign investment negotiations could well prolong the process of project appraisal and thereby damage the country’s investment climate.

6. Conclusion

Since the election of the Somare Government, Papua New Guinea has made rapid progress towards defining its foreign investment policies and establishing the mechanisms for their implementation. However, in view of the foregoing comments a process of reappraisal and consolidation would now seem appropriate.As the international economy recovers through the late 1970's, Papua New Guinea can anticipate the increasing interest of foreign investors, and should therefore refine its handling of foreign investment matters so that it can obtain the maximum advantage from these developments.

PART TWO

THE ADVANTAGES AND DISADVANTAGES OF FOREIGN INVESTMENT IN PAPUA NEW GUINEA : A REVIEW OF THE THEORY

Introduction

There are two broad categories of private foreign investment. Portfolio investment relates to the acquisition of equity shares without management participation. Direct investment implies that the investor controls the project by virtue of his ownership rights giving managerial influence.

A firm may extend its operations internationally so as to market certain products or to procure certain inputs. It may do so by means of trading of investing internationally. The basic motivation behind foreign investment is the prospect of earning a return on the invested resources, be they capital, technology, or expertise.

A foreign subsidiary may be established to furnish raw material inputs for the domestic operations of the parent company, or for buyers on the world markets. Such ventures generally involve some extraction of the host country's natural resources, and are motivated by the advantages to be gained from providing an assured source of supply.

Foreign subsidiaries may also be established in an effort to market the parent company's products or to duplicate the parent's manufacturing operation. Such operations involve the establishment of manufacturing or service industry, and may be motivated by the advantages of securing an assured market or by the advantages of relocating part of an existing operation so as to reduce overall costs. The choice between production in the parent's home plant in conjunction with export marketing arrangements, and production located in a foreign market is likely to be influenced by considerations of comparative efficiency (including the availability and cost of factor inputs,the ease with which these inputs are transformed into the final product, and the cost of transporting this from its point of production to its point of sale);together with considerations of commercial and political risk.

Foreign investment poses something of a paradox for the government of Papua New Guinea.On the one hand increased foreign investmet is seen as being necessary for the development of the country’s industrial and resource base, and this development is in turn needed to finance the education, transport, health, and agricultural extension programmes that are the basis of rural development.On the other hand, foreign investment is likely to be accompanied by various conflicts of interest between the foreign firms and the country itself.Under these circumstances it can be argued that, notwithstanding foreign investment’s potential stimulus to the development process, a slower growth may well be preferable.

The issue is a contentious one which has attracted considerable comment in Papua New Guinea.The following discussions explores the implications of private foreign investment in Papua New Guinea by identifying the possible benefits and costs which may accrue to the country as a result of its accepting such investment.

8. Capital Formation

Papua New Guinea’s productive capacity is dependent on its natural resource endowments as well as on its accumulations of capital (defined as including all output generating assets other than natural resources i.e. physical assets such as industry plant and equipment, transport infrastructure, and power supply; as well as more abstract assets such as human skill). The country’s stock of capital can be increased through investment activities which may be financed from either domestic savings or from foreign savings in the form of aid, loans and foreign investment.

It follows that there are a number of ways in which Papua New Guinea can acquire the capital necessary for the extraction of her natural resources, her industrialisation, and rural development.

Capital can be generated internally. However the large subsistence sector of the economy means that there is limited scope for extracting domestic savings for investment purposes. Because some 75% of the indigenous population still live either wholly or mainly in the subsistence economy (33), over-reliance on internally generated capital would mean that the country will have to wait a very long time for further benefits of development. Given existing expectations among the national population, avoidable delay in development is unlikely to be politically acceptable. The comparatively small contribution made by domestic savings to national investment is illustrated by the following figures:

Sources of Investment Funds (Millions of Kina) (34)

	1968/69	1969/70	1970/71	1971/72	1972/73
Gross Domestic Savings	10.9	23.4	75.9	46.8	22.8
Net Transfers from Abroad	105.3	174.1	216.3	188.7	146.0
Total Investment	116.2	196.5	292.2	235.5	168.8

One aspect of utilizing domestic savings is the generation of export earnings which can in turn be used to import capital requirements. In this respect, circumstances have changed considerably since 1972/73. Regardless of the setbacks caused by the world recession of the mid 1970's growing world shortages of minerals, energy and timber have raised the price of these resources to the point where it is becoming Economical to exploit them in Papua New Guinea despite the high development costs associated with the country's difficult terrain and poorly developed infrastructure. (35)Furthermore there are indications that the terms of trade for Papua New Guinea's tropical export crops will continue to improve over the coming decade.

To some extent Papua New Guinea can rely on receipts of foreign aid. In March 1976, Australia made a firm commitment of aid to Papua New Guinea whereby a minimum A$180 million a year will be provided over a five year period.However the level of this anticipated aid is well below the country's investment requirements.

It may be possible to borrow the finance necessary to establish and operate government enterprise to be used in exploiting the country's natural resources, or in producing other desired output. However the cost of doing so on a large scale would likely prove prohibitive, despite the limited availability of "soft loans" from bodies such as the World Bank.Furthermore, over-,reliance on inexperienced government corporations for the development of various ventures is likely to entail some inefficiencies and avoidable delay.(36)In any case, the extent to which development projects can be financed through loans is limited by repayment capabilities and longer term balance of payments considerations.

Another means of capital formation in Papua New Guinea is by way of attracting private foreign investment. Such investment will constitute an important source of capital provided the investment is financed from foreign, as distinct from domestic, savings.(Unless the domestic savings would be left idle if not used by foreign investors).The significance of foreign investment in the fixed capital formation of Papua New Guinea is illustrated by the following figures:

Capital Formation (Millions of Kina)(37)

Year	Gross Fixed Capital Formation	Mining Investment	Foreign Investment Inflow	Foreign Investment as % of Capital Formation
1967/68	83.2	-	29.9	35.9
1968/69	91.4	10.9	37.4	40.9
1969/70	182.4	68.1	98.2	53.8
1970/71	276.1	158.4	192.6	69.8
1971/72	241.7	143.0	169.8	70.3
1972/73	129.8	24.9	29.2	22.5
1973/74	130.7	66.9	96.3	73.7
1974/75	160.7	- 48.2	- 20.6	- 12.8

The foreign investment figures include shares, debentures, loans, advances and undistributed profits.They represent net inflows which means that increases in investment are offset by withdrawals of investment. They indicate that for the period in question, foreign investment has been responsible for a substantial proportion of the country’s capital formation. However the construction phase of the Bougainville Copper Project accounted for most of the foreign investment inflows. The chances of another major extractive project proceeding within the next decade are reasonably good given that the government is actively pursuing projects such as the OK Tedi copper mine, the Vanimo forestry and pulp mill complex, and a petroleum find in the Gulf of Papua.

9. Modern Technology

The use of modern technology may contribute to national development.Because Papua New Guinea lacks the resources to undertake substantial research and development, she is forced to rely on foreign technology. Such technology can be imported through licensing arrangements, foreign aid, the recruitment of skilled manpower from abroad, or through foreign investment.

Papua New Guinea’s commercial livestock and agricultural production is largely dependent on foreign technology. This was first introduced through foreign investment in plantations, and now through government extension services and foreign investment in nucleus estates. Virtually all secondary and service industry was developed with foreign technology introduced through foreign investment.

Because most foreign investment is undertaken by firms having benefited from prior experience in similar ventures elsewhere the acquired expertise of the parent company is likely to convey benefits to its foreign subsidiary in terms of improved techniques of production, marketing methods, and management procedures; as well as in terms of better access to sources of foreign capital and to foreign markets.

While it may be possible for Papua New Guinea to gain access to such advanced techniques through various licensing arrangements or the recruitment of foreign personnel, it is generally the case that an experienced foreign firm is capable of bringing together with the components of a major project far more quickly and at very much lower cost than an inexperienced government corporation or private national firm.

However there are certain disadvantages for a country which remains almost totally reliant on foreign techniques. Such a country is unlikely to develop its own research and development facilities capable of providing technology which is appropriate to the particular circumstances of the country.It has been argued that the use of inappropriate technology can result in a misallocation of a country’s resources.(38)On the other hand it can be argued that it is cheaper to transplant an already known technology to an environment to which it is not entirely appropriate, and thereby incur some additional cost in terms of inferior efficiency, than to develop a new technology more appropriate to that environment. (39)

10. Manpower Training and Industry Linkage (40)

In addition to the direct contributions to national productivity which may accompany the imported technology associated with foreign investment, a number of spillovers can occur whereby expertise is spread beyond the confines of particular foreign investors. Manpower training in a foreign firm provides an opportunity for improving the commercial skills of the local workforce. The benefits from in-service training and work experience gained from employment with foreign investors is further stimulated in Papua New Guinea by government imposed restrictions on the employment of expatriates. Workforce mobility between foreign and national firms tends to spread these benefits.

Foreign investment can also benefit the host country through the establishment of one foreign firm acting as a catalyst to the establishment of several other firms by virtue of its providing them a ready market or convenient source of inputs. Papua New Guinea’s brewing industry provides an example of this type of linkage.It encouraged the establishment of a local packaging industry (including manufacturers of metal cans, cartons, bottles and crown seals) by providing an assured market for these products.

There is also the possibility of foreign investors improving the techniques employed by associated national firms, particularly in the case of subcontract ventures operating under certain management arrangements or quality controls. A case in point is provided by Ready Mixed Concrete (NG) Pty. Ltd who are sponsoring former employees into subcontracting arrangements for delivering their concrete. These national sub-contractors are assisted with finance from the Development Bank and management guidance from Readymix. (41)

11. Employment Creation

Benefits from foreign investment in Papua New Guinea can accrue to the country in the form of employment creation. The latest available figures show that only 193,000 Papua New Guineans had access to wage employment during 1971.(42) Of these, 52,000 were government employed (43) and the remaining 141,000 were employed in the modern private sector of the economy which has been financed predominantly by foreign investment.

One of the most serious problems to confront Papua New Guinea over the foreseeble future is mounting unemployment. On the one hand there is going to be a rapid increase in the number of people seeking wage employment as a result o£ increasing numbers of people graduating from the country’s educational institutions with aspirations for modern sector wage employment; escalating real wages which have acted as an encouragement for people to seek wage employment;and a 3% growth in population coupled with a continued high level migration from rural to urban areas (the proportion of the national population resident in urban areas is anticipated to increase from its present level of 10% to 23% by 1986). (44)

On the other hand Papua New Guinea can anticipate only limited expansion in the number of available wage earning jobs because of a curtailment in growth in the modern private sector due to the generally depressed economic conditions of 1974/75 and 1975/76, the erosion of business confidence associated with Self Government and Independence, and the high cost of labour in relation to its quality.

In view of these unemployment prospects, the employment creation associated with further foreign investment in Papua New Guinea should be of benefit to the country.

12. Tax Contribution

Papua New Guinea will benefit from the establishment of profitable foreign firms by virtue of their contributions to tax revenue. At present foreign firms operating in Papua New Guinea pay 33.3% of their profits in company tax together with a further 15% dividend withholding tax payable on those dividends remitted abroad.Some firms also pay excise on their production.The significance of such payments in Papua New Guinea is reflected in the following figures :(45)

Company Tax Payments (Millions of Kina)

Year	Company Income Tax	Dividend Witholding Tax	Excise	Total	Total as % of Internal Revenue
1971/72	15.6	-	8.9	24.5	28.9
1972/73	14.1	1.0	11.4	27.4	29.4
1973/74	11.4	11.2	17.1	39.7	29.1
1974/75	28.5	10.1	20.3	58.9	33.2
1975/76	19.5	1.9	29.0	50.4	22.5

Under the Mineral Resources Stabilisation Fund Act 1974, all income tax and dividend withholding tax from companies operating Special Mining Leases are paid into the Mineral Resources Stabilisation Fund and so do not appear in these figures. These circumstances apply to Bougainville Copper Ltd. During 1975/76 this fund (which also includes dividends payable on government equity) contributed K45 million to government revenue.

Given that the modern private sector in Papua New Guinea is dominated by foreign firms and that many national firms are operating under a tax holiday, it follows that the above figures give a reasonable indication of the contribution which foreign investment has made to Papua New Guinea's government revenue.

The revenue contribution from extractive industry is of particular interest. There are big uncertainities relating to the timing and magnitude of major foreign investments.Thus even though extractive projects can have a very large impact on domestic revenue, they are never certain until successfully in production. A further point of interest is that the government aims to impose taxes over the above the regular rate of income tax in those circumstances where fluctuations in world commodity prices give rise to unusually high profits. By this mechanism Papua New Guinea will attempt to ensure that it will retain a substantial share of the exploitable value of her resources. This principle of excess profits tax was applied in the revised Bougainville Copper Agreement.

13. Consumer Benefit or Loss

Local consumers may benefit from foreign investment which serves the domestic market by virtue of lower prices, better quality products, and an expanded product range associated with such investments. Prices may be lowered because the product is no longer imported and hence no longer embodies transport and tariff costs.However, where import replacement is assisted by tariffs, prices may be increased to the detriment of the consumer. Technical and management expertise from abroad may improve the quality of products on the domestic market, and foreign investment may launch new products, thereby broadening the range of products available to local consumers.

Initially most foreign investment activity in Papua New Guinea was export oriented, and so had little direct influence on consumer welfare. However much of the country's foreign secondary industry has been in the field of import competing goods. In the case of those import replacement industries which are naturally sheltered as a result of perishability or high transport costs, foreign investment has probably contributed to consumer welfare (bakeries would be a case in point). On the other hand, those industries receiving high tariff protection, such as cigarette manufacturing, would be to the detriment of local consumers.(46)

14. The Balance of Payments

The balance of payments effect of foreign investment can be either beneficial or detrimental to the host country, depending on the relative strengths of the specific influences listed below:

(a) The immediate direct effects :

- An inflow of foreign capital from the parent company needed to finance the investment project (this is beneficial to the balance of payments)'.
- An outflow of foreign exchange in payment for overseas purchases associated with the initial investment i.e. in payment for imported capital equipment and components needed for the project (this is detrimental to the balance of payments).

(b) The long term direct effect:

- This is associated with “servicing” the capital invested. It involves the income commitment to the parent company in the form of foreign exchange remissions. The amount remitted depends on the rate of profit earned by the subsidiary together with the ratio of reinvested to distributed profits. It also depends on the interest payable on invested capital and any royalties, service fees, or management fees owing to the parent company.(This is detrimental to the balance of payments).

(c) The long term indirect effects associated with foreign trade implications :

- Import replacement may result from the output of a foreign subsidiary replacing goods which were previously imported. (This is beneficial to the balance of payments).
- Export generation is usually associated with foreign investment in the extraction of natural resources such as the Bougainville Copper Project. However, manufacturing subsidiaries may begin exports from the host country, particularly if it has the advantages of cheap labour and other inputs.(This is beneficial to the balance of payments.)
- Import generation may result from additional imports of components or capital equipment needed by the foreign firm.(This is detrimental to the balance of payments.)In the case of import replacing foreign investment, the associated foreign trade effects are likely to conserve the host country’s foreign exchange reserves. However, the situation could arise where the operations of the foreign subsidiary expand the local

consumption of its output to the point where the value of imported components required by the subsidiary exceeds what would have been the value of the fully imported finished product in the absence of local production by the foreign investor. Under these circumstances, the foreign trade effects associated with import-replacement investment will deplete the host country's foreign exchange reserves.

During the development stage o£ a particular project, the new capital inflows are likely to exceed any outflows associated with "servicing" the investment because it is likely that foreign firms will retain the greater part of their earnings for re-investment. Thus any adverse pressure on the balance of payments normally associated with servicing the foreign investment is postponed.(47) No problem becomes apparent from this reinvestment of profits until such time as the foreign firm discontinues reinvesting. Dividends must then be paid on the investment which has since been expanded through re-investment of profits. Consequently one can expect larger profits and so larger dividends and, by implication, greater pressure on the balance of payments.

Thus, by the time the subsidiary has matured so that it is paying dividends to its parent company, these out-payments may well be very large in relation to the initital investment. However by this stage the trade effects, particularly import-replacement in the case of manufacturing firms, or export-generation in the case of extractive industry, are likely to be such that they counter adverse balance of payments effects associated with servicing the investment. Where this does not eventuate, the investment servicing will be financed by running down the country's international reserves. Provided the country has large international reserves, such action will have little adverse effect on the domestic economy. However in cases where reserves are already depleted, the country may raise foreign loans, or failing that, generate international reserves by ensuring that export earnings exceed Import payments. This can be attempted trough currency devaluation, a dampening of the domestic spending power, or import restrictions by way of tariffs and quotas.

Figures necessary to fully illustrate these various influences in Papua New Guinea are not readily available because, for as long as Papua New Guinea remained a dependency of Australia, its foreign accounts were merged into those of Australia. As a result there is no clear record of the country's balance of payments prior to Independence. Despite these difficulties, the following sets of figures give some indication of the circumstances.

Reinvestment of Company Profits(Millions of Kina)(48)

	Net Profits	Dividends Paid	Retained Profit	Reinvestment Ratio
1967/68	30.2	9.6	20.6	68.2 %
1968/69	34.2	12.9	21.3	62.3 %
1969/70	43.7	13.4	30.3	69.3 %
1970/71	54.9	20.3	34.6	63.0 %
1971/72	52.4	28.1	24.3	46.4 %
1972/73	42.8	23.4	19.4	45.3 %
1973/74	50.6	22.6	28.0	55.3 %

Note: Net Profits = taxable income less net income tax.

Because Bougainville Copper Ltd. initially operated under a tax holiday, its profits do not appear in these figures.

Capital Inflows and Income Repatriations Associated with Private Foreign Investment (Millions of Kina) (49)

Year	Inflows	Outflows	Financial Balance
1967/68	29.9	14.7	+15.2
1968/69	37.4	15.8	+21.6
1969/70	98.2	20.3	+77.9
1970/71	192.6	22.2	+170.4
1971/72	169.9	37.0	+132.9
1972/73	29.2	88.2	-59.0
1973/74	96.3	205.7	-109.4

These figures give an indication of the inflows of foreign capital which have financed subsidiary operations in the country, together with the "servicing" burden incurred on these and prior investments. The comparatively high reinvestment of company profits has, until recently, contributed to a favourable foreign investment financial balance. Apparently the unfavourable balance since 1972/73 has been due in part to a loss of business confidence which has both discouraged new investment inflows and motivated increased repatriations of foreign funds from the country. Such movements are to the detriment of the country's balance of payments.

Because foreign business in Papua New Guinea constitutes such an important sector of the economy, any sudden major outflow of funds in the form of loan repayments and profit repatriations, could seriously disrupt the financial stability of the nation. This possibility provides justification for the imposition of government exchange controls on international financial flows,notwithstanding the fact that such protective measures increase the risk incurred by foreign investors.

It is more difficult to isolate the foreign trade effects associated with foreign investment, that is the import replacement, importgeneration, and export-generation. Papua New Guinea’s overall trade situation is reflected in the following figures:

Balance of Trade (Millions of Kina) (50)

Year	Exports	Imports	Trade Balance
1971/72	97.8	271.2	-173.4
1972/73	241.9	204.4	+37.5
1973/74	460.1	224.8	+235.3
1974/75	375.5	360.5	+15.0

While a lack of data prevents a precise separation of those imports and exports which are connected with foreign investment, the following break-downs give some indication of the situation.

Percentage Composition of Imports

	1971/72	1972/73	1974/74	1974/75
Consumer Goods	35.2	48.2	50.1	51.1
Intermediate Goods	7.3	8.9	12.7	15.7
Capital Goods	56.4	41.6	34.6	30.4
Other	1.1	1.3	2.6	2.8
Total Imports	100.0	100.0	100.0	100.0

A fairly high proportion of both the intermediate goods and capital goods would be associated with foreign investment. Furthermore the workforce employed by foreign investors will spend a proportion of its earnings on imported consumer goods. From this basis it is estimated that some 40% of all imports can be attributed to foreign investors.

Percentage Composition of Exports

	1971/72	1972/73	1973/74	1974/75
Copper	27.6	68.3	68.7	57.7
Copra Products	15.6	6.0	5.2	10.6
Cocoa	11.3	4.7	5.1	9.5
Coffee	21.0	9.9	6.2	8.2
Timber	9.2	4.5	4.4	3.1
Others	15.3	6.6	7.4	10.9
Total Exports	100.0	100.0	100.0	100.0

The copper and timber exports are predominantly the result of foreign investment. To a lesser extent, plantation exports are also the result of foreign investment. From this basis it is estimated that between 65- 70 % of export earnings are attributable to foreign investment.

In view of the trade balance situation and the estimate that some 65% of the country's exports are are associated with foreign investors while only 40% of imports are directly attributable to foreign investors,it would appear that the international trade effects associated with foreign investment in Papua New Guinea have, in general, been beneficial to the country's balance of payments.

The overall influence of foreign investment on the country's balance of payment is dependent on both the associated capital and trade flows.

While a lack of data precludes any definite conclusions, it would appear from the above considerations that foreign investment in Papua New Guinea has been beneficial to the balance of payments during the 1970s.

15. Preclusion of Domestic Firms

It may be the case that, because of the limited size of certain markets in Papua New Guinea, the admission of a foreign firm to service a particular market may preclude the development of domestic firms in that market. However, this argument is dependent on the assumption that a local firm would eventually be forthcoming.It may well be that a lack of capital, entrepreneural talent, and technical knowhow, would preclude such development, or be responsible for delay in its implementation. If this is the case, then the cost of the delay may well outweigh the costs associated with having a foreign rather than a domestic firm in a particular industry.(51)Furthermore the Investment Corporation of Papua New Guinea is a mechanism whereby established foreign firms can be converted to local ownership.(This institution was establishedin 1972 for the purpose of acquiring equity in foreign owned enterprises.Its resources are, of course, limited.)

16. Export Restrictions

The parent company of some foreign subsidiaries may impose restricted export franchise as a means of rationalizing its international marketing and investment strategy. A multinational firm will seek to prevent “market-cannibalism” between its various subsidiaries by directing that certain export markets are to be serviced only by nominated subsidiaries, irrespective of whether other subsidiaries have the capability of exporting successfully. A multinational firm may also stipulate that a certain export market is to be served only by a specific subsidiary so as to enable that plant to obtain economies of scale through exports. Such directives impose a cost on the host country in those cases where it has the potential to export profitably.

At Papua New Guinea’s present stage of development, this consideration is of little relevance in so far as manufactured exports are concerned. However there is a danger of parent company directives temporily cutting back the production in extractive industry oriented to supplying inputs for the parent company operation. However such moves would generally reflect the overall market situation for the product in question.

17. Import Bias

It has been argued that the centralized decision making within a multinational firm can result in its various foreign subsidiaries having a high import prospensity to the neglect of domestic or other cheaper sources of supply. The foreign subsidiaries of a multinational firm may be under obligation to purchase various inputs from their parent company. This is likely to be detrimental to the host country wishing to develop its local industries.(52)

In the case of Papua New Guinea, there is a marked bias towards Australian sources of supply. Over 50% of all imports come from Australia which is considered to be a high-cost supplier (particularly so prior to the December 1976 devaluation). These strong trade ties with Australia are partially a reflection of the Australian colonial administration and of Australian foreign investment whose staff have knowledge of Australian suppliers. However in certain instances, Papua New Guinea importers are disadvanted because they are forced to import through Australian agents rather than directly from the country of origin.(53)

18. Intra-Firm Pricing (54)

The pricing policies of multinational firms may impose certain costs on those countries in which they operate. Intra-firm pricing policies may create a situation in which imports are over-priced and/or exports are under-priced as between subsidiaries of a firm operating in a number of different countries.Such price manipulation may be motivated by a desire to minimise global tax payments through shunting profits to whatever country it finds fiscally advantageous, or by an attempt to circumvent restrictions on profit repatriations.

In view of these considerations, Papua New Guinea stands to benefit from the activities of NIDA in so far as this authority is capable of minimising distortions in the pricing of material inputs and the various service and management arrangements which foreign subsidiaries purchase from their parent company, and of ensuring that the price which a foreign subsidiary receives for its exports is undistorted.

While NIDA has the theoretical power to prevent such practices, it is questionable whether it has the capability.This is because NIDA lacks the detailed information necessary to identify transfer pricing arrangements. one of the NIDA's first activities was to undertake a registration of the business activities already operating in the country. Part of these notification requirements was the provision of information on any agreement (with other firms) involving foreign exchange transactions. However this information could assist NIDA identify distortions in the price of inputs supplied by foreign parent companies only if NIDA was aware of the normal price for such inputs.

In the case of pricing exports from Papua New Guinea's extractive industry, the government intends to establish a norm price (which will, wherever possible, be the free market price) to assess the taxable income and royalty payments of extractive industry. (55) However there are practical difficulties associated with administering such a scheme because of the difficulty in monitoring fluctuating world prices.

Possibly there can be some protection gained by encouraging consortium arrangements for major extractive projects, as has been the case with OK Tedi. There is less likelihood of price manipulation where the various interests of the consorium members are not fully coincident.

19. Investment Incentives

It is argued that firms may be inhibited from undertaking investment in Papua New Guinea by the limited size of her domestic markets; the high costs in relation to quality of certain inputs such as power, transport, and labour;(56)and the political uncertainities associated with a newly independent state. In view of these deterants certain firms contemplating investment in the country seek fiscal incentives.

While such inducements may improve the investment climate of the country they do so at a cost in terms of an expenditure of public funds, forgone taxation income, or a loss of consumer welfare. There is a danger that competition between the developing countries in attracting foreign investment will bid up the terms on which any one nation can obtain such investment:(57) There is also a danger that foreign investors will establish a marginally viable operation and, once set up and employing people pressure the government for assistance needed to keep the venture operational. Such pressure is difficult for a government to resist because of the political implications associated with the loss of jobs which would result from a close down. NIDA is attempting to pre-empt such practices by insisting that the nature and duration of government assistance will be agreed to before the establishment of the proposed industry.(58)

20. Influence over Domestic Policy

Foreign investment may constitute a threat to national independence by virtue of its facilitating foreign control over various domestic resources and thereby exerting some influence over domestic policy. While it is inevitable that the international integration associated with foreign investment will involve some degree of compromise to national independence, it is not necessarily the case that such compromise will be to the detriment of the country accepting foreign investment.

However, there is also a very real danger that manipulation of government by certain foreign investors will be attempted without regard to the national interest. In order to guard against such possibilities, the government should attempt, in so far as it is possible, to ensure that foreign investors’ efforts to exert influence are opened to public scrutiny. An example of this is provided by the renegotiated Bougainville Copper Agreement, one clause of which states that Bougainville Copper Ltd. can make donations only with approval of the government nominated directors of the company.(59)

It should be pointed out that the responsibility for corrupt practices involving foreign investors and the government lies with both parties. It is probably unrealistic to expect a foreign investor to maintain a standard of conduct which is higher than is usual in a particular country.

Thus where an environment is corrupt, there is every likelihood that investors operating in that environment will act accordingly.Papua New Guinea is fortunate in this regard because its government is basically uncorrupt. However the government is conscious of the problem of corruption, and has established an ombudsman Commission which requires leading public figures to lodge details of their personal wealth and financial dealings with its offices.

21. Distortions Due to International Competitive Pressure

Many of the large international firms operate in an oligopolistic world market in which market developments by one firm are soon matched by its competitors. Because of these circumstances, the opportunity to establish a local plant serving the domestic market in a developing country such as Papua New Guinea will confront prospective investors with a dilemma. On the one hand there will be strong inducements for a number of competing firms to establish local operations in that country so that no one subsidiary is placed in the position of being able to dominate the market. On the other hand, it is unlikely that the comparatively small local market could support more than one fully utilized plant. Under these circumstances, an open door policy to foreign investment could well result in the establishment of a number of import replacement factories producing basically the same product, each operating at less than full capacity.Given this possibility, the efficient use of the host country's available resources would seem to justify some form of control over the entry of foreign firms contemplating import substituting manufacurer.

A case in point is provided by Papua New Guinea’s brewing industry in which two major international brewing corporations, the Dutch based Heineken Group and the Philippines based San Miguel Corporation, compete through subsidiary operations in a market which supports only one of the firms profitably. However Papua New Guinea will not necessarily lose as a result of such completion. Even if a foreign investor is operating inefficiently or unprofitably in import replacement activities, there will be no loss to the country provided that the enterprise does not absorb national resources which could be better used elsewhere, and provided that it receives no government assistance.

Conclusion

In the light of this discussion of the possible benefits and costs associated with foreign investment in Papua New Guinea it can be concluded that foreign investment can provide worthwhile development gains for the host country; and that government control over foreign investment is both necessary and inevitable.

REFERENCES

(1)Central Planning Office "The Post Independence National Development Strategy" 17th October, 1976 pages 18 & 19

(2)Ministry of Labour Commerce and Industry "Papua New Guinea National Investment Strategy" November, 1976, page 9

(3)Prior to 1946 the Australian administration of Papua New Guinea was oriented towards the pacification and protection of the indigenous population and not towards their rapid development. After 1946 the Australian administration implemented a policy of slow uniform development whereby efforts were concentrated on the development of the country's backward areas, particularly the Highland valleys. Following adverse United Nations criticism in the early 1960s, Australia implemented a strategy of selective development under which available funds were spent where the anticipated return was greatest, and expatriate expertise and capital was used to develop export oriented industries. This approach aimed at maximizing economic growth so as to generate some measure of economic self sufficiency by the time political independence eventuated, Refer West F. "Papua New Guinea: Australian Policy Review". Current Affairs Bulletin June 1972.

(4)Garnaut R "Neo Colonialism and Independence : Papua New Guinea's Economic Relations with Australia and Japan" Japan-Australia Society Symposium, March 1975, page 14

(5)NIDA "Framework for Industrial Development in Papua New Guinea" September 1975 page 2.

(6)Ministry of Labour Commerce & Industry op. cit. page 21.

(7)Ministry of Finance "Government Statement on Petroleum Policy and Legislation" March 1976 page 6.

(8)NIDA "The Third National Investment Priorities Schedule"

(9)Ministry of Labour Commerce & Industry op. cit. pages 22 to 24

(10)NIDA "Framework for Industrial Development" op. cit. page 8

(11)PNG Government press release number 2058 GW/HA/SC November 8, 1976

(12)Ministry of Labour Commerce & Industry op. cit. pages 30 and 35

REFERENCES (Cont.)

(13)Central Planning Office "National Development Strategy" op. cit. pages 40 and 4_l.

(14)Minister for Finance "Budget Speech 1976/77'"

(15)There have been cases where the decision on an application for a price rise has been delayed for nine months.

(16)The Mineral Resources Stabilisation Fund is an example.

(17)Refer to the discussion on page 12

(18)Refer to the discussion on pages 3 and 4

(19)National Investment and Development Act 1974 section 44 schedule 5.

(20)ibid section 8 schedule 1 (23)

(21)NIDA "The Third National Investment Priorities Schedule"Section 3 (3)

(22)Minist6ry of Labour commerce and industry op. cit. page 19

(23)Papua New Guinea Tariff Advisory Committee "Annual Report for Year Ended 31st December 1972" pages 23 to 25

(24)Refer to Carlson S. "The International Transmission of Information and the Business Firm" The Annals of the American Academy of Polical and Social Science" Vol. 412 March 1974 page 57.and Vernon R. "International Investment and International Trade in the Product Cycle" printed in "International Investment" op.cit. page 307

(25)Allen T."The National Investment and Development Authority:" Its Structure, Functions and Aims" August 1975 page 2 (a NIDA publication)

(26)For example the guidelines call for the development of Papua New Guinea enterprises and also call for Papua New Guinea equity in foreign enterprises. Given that domestic savings are limited, the acquisition of national equity in foreign firms will to some extent preclude the development of local industry.

REFERENCES (Cont.)

(27)Refer for example to Government Gazette number G97 9th December, 1976 which documents the registration of an electrical contractor subject to his acquiring local equity participation. Gazette number G99, 23rd December 1976 which documentsthe registration of a milk bar project to the acquisition of local equity.

(28)National Investment and Development Act 1974 sections 42 (a) and 56 (2)

(29)ibid section 56 (13)

(30)ibid section 12 (2) a

(31)Third National Investment Priorities Schedule section 4 (5)

(32)Ministry of Labour Commerce and industry op. cit. page 28

(33)Vulupindi J. "The Economy" printed in "Papua New Guinea" Office of Information, PNG Government 1975

(34)Central Planning Office "Papua New Guinea's Improvement Plan for 1973/74" page 22

(35)Garnaut R & Clunies Ross A. "Using Natural Resources to Achieve National Goals" printed in Yagl—Ambu, the Papua New Guinea Journal of the Social Sciences and Humanities Vol. 1, No.1 March, 1974.

(36)Garnaut R & Clunies Ross A. ibid page 55

(37)Bureau of Statistics "Private Overseas Investment 1967/681973/74" and "National Accounts Statistics 1974/75".

(38)Parry T. G, "The International Firm and National Economic Policy: A Survey" ANZAAS 43rd Congress, May 1971, Section 24 page 11.

(39)Johnson H.C. "The Efficiency and welfare Implications of the International Corporation" page 461 printed in "International Investment" Ed. J.' H, Dunning, Penguin Books.

(40)Refer to Meier GM, "Private Foreign Investment" reprinted in "International Investment" ibid.

REFERENCES (Cont.)

(41)The Post Courier 22nd December 1976, page 19

(42)Central Planning Office op. cit. page 21

(43)Bureau of Statistics "Population Characteristics – Bulletin No.1 1971 Population Census".

(44)Central Planning Office "Population Urbanisation and Employment 1971/1981" Manpower Planning Unit: Discussion Paper No.1

(45)Department of Finance "Estimates of Revenue and Expenditure for the Year Ending 30th June, 1977".

(46)Refer to Irlam W.R. "A Sectoral Study of the Food, Drink and Tobacco Manufacturing Industry in Papua and New Guinea" 42nd Congress of ANZAAS, August 1970.

(47)Penrose E.T. "Foreign Investment and Growth of the Firm" printed, in "International Investment" op cit. page 258

(48)Bureau of Statistics "Taxation Statistics 1972/73" page 18

(49)Bureau of Statistics "Private Ovarseas Investment 1967/68 ., 1973/74" op. cit

(50)Bureau of Statistics. "National Accounts Statistics – 1974/75" page 11

(51)Gray H.P. "The Economics of Business Investment Abroad" page 116 The Macmillan Press Ltd.

(52)Parry T. G. "The International Firm and National Economic Policy: A Survey" ANZAAS 43rd Congress, May 1971 section 24 page 10

(53)Bank of Papua New Guinea "Quarterly Economic Bulletin" March 1976 page 33 Port Moresby Chamber of Commerce "Minutes of the Meeting of the Executive Committee".6th September 1976 – Reference to correspondence from the Department of Foreign Relations and Trade regarding the cost of imports.

(54)Wheelwright E.L. "Development and Dependence: The Australian Problem" "The Australian Quarterly" Sept. 1971.

REFERENCES (Cont.)

(55)Papua New Guinea Government “Statement on Petroleum Policy and Legislation” March 1976 page 18

(56)Ministry of Labour Commerce and Industry “Papua New Guinea National Investment Strategy” November 1976 page 31

(57)Parry T. G. op. cit. page 16

(58)NIDA ‘The Third National Investment Priorities Schedule” Section 3 (5)

(59)Papua New Guinea National Parliament “Mining Bougainville Copper Agreement Act” No. 79 of 1974 Clause 6 8B. Donations.

THE INSTITUTE OF NATIONAL AFFAIRS SEMINAR ON FOREIGN INVESTMENT POLICY

PROPOSITIONS FOR DISCUSSION

1. Government control over foreign investment is both necessary and inevitable (part two).

2. Foreign investment policy should be clearly defined (so that potential investors know where they stand) rather than left as a loosely defined framework of principles which provide maximum manouverability in government/investor negotiations.

3. The official investment policy should be clearly outlined in documents of general application, rather than left to a case by case clarification in the agreements negotiated with particular investors.

4. Government negotiators should be disciplined by a rigid set of pragmatic criteria when evaluating investment proposals.

5. There are three broad approaches to attracting foreign investment to Papua New Guinea, fostering a good investment climate, providing specific information on the investment opportunities available in the country, and by providing fiscal investment incentives. By far the most effective, least costly means of attracting foreign investment is by minimising the risk and obstruction associated with investment in Papua New Guinea.

6. The most important considerations to a country’s investment climate are its political stability; how well the economy is managed; the extent to which investment screening is obstructive and prolonged; the difficulty faced by the investor in obtaining land, housing and a skilled workforce; the extent to which government measures such as prices justification are professionally executed; and the degree of security offered to the investor.

7. Information incentives are more effective than fiscal incentives.

8. Fiscal incentives should be oriented to reducing the investors risk rather than contributing to his profit. The cost of fiscal incentives should be readily quantified, and in normal circumstances should be “once-off” rather than “on-going’.

9. Given the rural development aims of the government, to what extent would it be inconsistent to give high levels of assistance to the manufacturing sector? To what extent should government and consumer funds be diverted to assist private industry?

10. An investor has a responsibility not only to his share holders, but also to his workforce. An investor should willingly contribute to the country’s social objectives.

11. It is desirable for government negotiators to impose conditions of entry on foreign investors.

12. Is national equity participation a sound approach to Papua New Guinean involvement in foreign investment? Are joint-ventures desirable? Are subcontracting arrangements under management guidance a good mechanism for fostering national business ventures?

13. Is the National Investment Priorities Schedule a good mechanism for informing potential investors of the government's attitude towards foreign investment in specific activities?

14. Is the registration of foreign investors desirable? Can the process be improved?

15. To what extent is it desirable to have a single authority responsible for foreign investment matters? Should these responsibilities be dissipated across a number of government departments? Is a statutory authority an appropriate body for co-ordinating foreign investment?

16. Should comparatively inefficient or high cost industry be prevented from investing in Papua New Guinea even where they are not involved in extracting the country's natural resources? Provided they receive no government assistance, there will be little loss to Papua New Guinea even where they are poorly managed.

17. Will foreign investment preclude the development of national enterprise?

18. Papua New Guinea has adequately clarified its investment policy in the extractive/natural resources sector but has a poorly formulated investment policy in the manufacturing and services sector.

19. To what extent can the Papua New Guinea investment climate be improved by more open and frank dialogue between government and the private sector? How should this be weighed against the danger of the government eroding its bargaining position through "showing its hands"?

20. How can foreign investment contribute to the government's rural development objectives.

21. An experienced foreign firm is generally capable of bringing together the components of a major project at a very much lower cost than inexperienced government corporation.

SEMINAR ON FOREIGN INVESTMENT POLICY TO BE HELD IN PORT MORESBY ON 3RD AUGUST - 1977

PROPOSED FORMAL ADDRESSES

1. 8.45 am

Opening and Welcoming Address

Mr W McLellan Managing Director New Guinea Industries

2. 9.00 am

A General outline of the Government's economic policies with specific reference to foreign investors

The Hon Mr J Chan Minister for Finance

3. 9.45 am

Problems confronted by investors who operate in the manufacturing and service sectors

Mr R Elias Co-Director Melanesian Soap Products

4. 10.45 am

A synopsis of present government thinking in relation to investment policy for extractive industries problems and prospects

Mr Nigel Agonia Secretary Department of Natural Resources

LUNCH BREAK

5. 1.30 pm

A personal review of the basic approaches necessary to attract foreign investment under terms which are acceptable to all parties, the current position, what needs to be done and what can or could be done

Mr M Bendall Managing Director W R Carpenters

6. 2.15 pm

A discussion of policy issues in relation to foreign investment policy in the manufacturing and service sectors and an outline of options open to the government in further developing its policy on foreign investment in these sectors

Mr P Daniel Assistant Director General Planning National Planning Office

7. 3.15 pm

A review of the problems confronting a large extractive investor who is contemplating a major project

Mr R Burge General Manager Minerals Division BHP

8. CHAIRMAN

Morning Session

Mr H ToRobert Governor

Bank of Papua New Guinea

Afternoon Session

Prof K Cleland PNG University of Technology, Lae

9. 3.45

Summing up and overview

Dr B Shaw

Economic Consultant

10. Drinks

Note: Each session will comprise a 20 minute formal address to be followed by 20 minutes of questions and discussion

The Honourable, the Minister for Finance, Mr Chan, distinguished guests, Ladies and Gentlemen, on behalf of the Institute of National Affairs I welcome you to this seminar on foreign investment policy.

At this stage I think it is desirable that I explain the concepts and reasons behind the establishment of the Institute.

If you will recall when the first National Government came to power in 1972 it was distrustful of both the Public Service (which had recently served as an Australian administration) and the foreign business community. Because of these misgivings the new Government leant towards academic institutions such as the New Guinea Research Unit and the University for advice in formulating new more nationalistic economic policies. Subsequently, a number of these comparatively young, academically well qualified research staff became very highly placed in the Public Service.

While there can be no doubt that some of these new people developed into extremely capable bureaucrats who were responsible for the good management of the economy during the world recession of the mid seventies, it is also not unfair to say that others were impractical and inexperienced idealists who contributed to a general deterioration in relations between the government and the private sector.

During the following years the government displayed little interest in opening dialogue with the private sector and for its part, the business community failed to adapt itself to the new circumstances. By and large, the private sector organisations resorted to aggressive and patronising press statements as a method of pressuring the government on certain issues – an approach which was not only unsuccessful, but actually damaging because it further isolated the business community from government decision making.Furthermore, the private sector viewpoints which were communicated to the goverment were often unconvincing because, without exception, our commercial organisations lacked the expertise needed to match the top professionals employed by the government.

There are now very definite indications that circumstances are changing again. During 1976 both the Central Planning office and NIDA approached the private sector on policy matters before they were finalised.It is now increasingly recognised that the private sector will play an important role in the future development of the country.It follows that it is now an appropriate time for the private sector to organise itself to provide a worthwhile input into government policy formulations. With the strict ceilings that have been imposed on employment of public servants, growth of private industry provides the only avenue for expansion of wage employment. Experience gained in well-managed industry is the best way to develop the commercial skills of our workforce and sub-contract arrangements with established firms is probably one of the more promising approaches to establishing local industry.

Private capital can facilitate growth in those industries that government cannot afford to finance (it is of interest to note that official statistics show that over the past ten years more than fifty percent of profits earned in Papua New Guinea have been re-invested).

It is in the context of this background that the formation of the Institute of National Affairs should be viewed. The founders of the Institute were concerned with establishing an organisation acceptable to the national government, and judging by the communications from various government officers, we have certainly achieved this objective. It was considered that the type of organisation most likely to be acceptable to the PNG situation is an independent, highly professional research unit.

Here it is appropriate for me to emphasise that the Institute of National Affairs has not been set up to be a pressure group, rather it is to be an organisation which will provide high quality, unbiased research on matters of interest to private enterprise. In communicating its findings to our sponsors, the government and other interested members of the community, we foresee the Institute developing into a very important two-way communication link.

The organisation has been structured in such a way as to preserve this independence. There will be no member firms as such so that financial donors will have no direct influence on Institute of National Affairs policy. We envisage the Institute as being concerned with the national welfare rather than with the more narrow interests of private enterprise (although we believe both are complimentary). For this reason the control of the Institute of National Affairs has been vested in a fifteen member council comprised of a broad cross section of community interests. While it might at first glance appear that we have too neutral an organisation which may be prevented from serving the interests of the donors, let me reassure you by saying that the councillors were very carefully selected on the basis of the contribution they are likely to make to the venture. Furthermore, the organisation is already being taken very seriously by the government, who is now actively seeking authoritative and professional views from the private sector. By including a number of top level public servants on the council we are assured of access to the highest levels of government decision making.

The Institute aims to provide top quality research of the same calibre as is available to the government. To ensure that we achieve this objective we are going to considerable effort in searching for a suitable man to fill the position of Director of Research.It is council's view that as a minimum, an economist with at least a masters degree, extensive work experience in private enterprise and preferably some government work experience is required. Hopefully such a man will be available from the present recruiting programme being conducted in the United Kingdom.

The council has responsibility for disciplining the research programme. Our research staff will have to investigate those matters specified by the council, and points of view must be actively convassed from various interest groups in the community so that our research staff do not put forward their individual opinions to the exclusion of those opinions of the various interest groups we have tried to represent on our council. All research is to be endorsed by the council prior to being published. The council will retain the right to choose the research topics. However, we are aware that this need for controlled research must be balanced against the danger of stifling or watering down the quality of our research.

Initially the research effort will concentrate on government policy issues which influence the private sector as a whole. Research papers produced by the Institute are to contain rigorous analysis, not superficial or emotional comment. The Institute of National Affairs will be receptive to all suggestions as to those issues requiring investigation, although the council will guard against spreading our research resources too widely so that the quality of our research suffers.Sponsors are to be kept fully informed of the Institute’s activities and deliberations, and will receive copies of all research material.

We will endeavour to establish a close working relationship with other Papua New Guinea private sector organisations. By this we are certainly not proposing to eventually usurp the role played by existing private sector organisations – far from it.

Rather we see ourselves as being able to assist and perhaps in some cases supplement the various private sector organisations through the skilled research facilities that will be established.

The research paper which was written for this seminar is an example of the type of work we will produce. We propose to carry out research on a series of policy issues such as – price control, decentralisation of industry, transportation policy, forest policy, localisation etc.

In so far as it is possible, the mechanism for dialogue between the Institute of National Affairs and the various interest groups in the community will be based on our Director of Research establishing close personal relationships with influential people in government, private firms, academic institutions, and labour organisations. Having established this rapport, it should be possible to discuss various issues in an open and constructive manner.

The preliminary fundraising effort has been quite successful. We now have donations of some K40,000 an amount which is still K10,000 short of our requirements during this very costly year of establishment. Donations to date have come from both large and small organisations and have ranged from K20 to K5,000.

Many donors have agreed to contribute to the support of the Institute for an initial period of three years. Donors and a council generally agree that it will require not less than three years to establish the facility and have it gain recognition as a primary communication medium between government and the private sector.

Let me conclude by informing you that I consider it imperative that the private sector needs to be in a position to make well researched professional comment on policy issues, many of which will vitally influence the success of the private sector. To be able to do this the Institute needs as broad a base of support as possible, not only because we need additional funds, but more importantly that our professional research secretariat can be seen as having wide support from within the private sector.

The function you are attending here today is the first public activity undertaken by the Institute, I hope you find the discussions of value.

SPEECH BY THE MINISTER FOR FINANCE, MR JULIUS CHAN, CBE, MP, AT THE INSTITUTE OF NATIONAL AFFAIRS SEMINAR, 3 AUGUST, 1977

I must congratulate the Institute of National Affairs for organising this seminar on Papua New Guinea's policies towards foreign investment.

For the last five years, as Minister for Finance, I have tried to encourage and promote as much free and open discussion about the fundamentals of economic policy as I could. At all stages in the evolution of the Government's policies, I have set out clearly and explicitly not only what the Government was doing but why it had decided to do things in that particular way.

Throughout, I have related policies and decisions to the strategic thinking that lay behind them. I also set up the Economic Affairs Council as a forum at which representatives of the Government, private business and labour could get together on a regular basis and talk over the questions about economic affairs that were uppermost in their minds. I am sure that today's discussions will contribute to this ongoing process of exchanging information and ideas.

I must say, however, that I have been rather disappointed at what has appeared to be a lack of involvement in national affairs on the part of the private sector. Virtually all the initiative has come from the Government side, and there is hardly ever a response from private business, except for the occasional complaint on such matters as taxation or localisation.

It is sometimes suggested that the Government should give more advance notice of legislation affecting the economy so that business can come up with its comments. Quite frankly this hardly seems worth the trouble as on past showing there is little likelihood that any constructive suggestions would come forward.

Sometimes I almost get the feeling that businessmen are ashamed of their occupation. But this would be a disastrous frame of mind. We do not live in a state-controlled economy, and I believe it is vital that the private sector should start to play a much fuller and more rigorous part in debate on national issues.

With a new government due to enter office in the next week, this is perhaps a good moment to review where we stand. As for looking ahead, that is a bit more problematical—no doubt, for that purpose, you would have done better to invite the next Minister for Finance—if you happen to know who he is going to be:

At all events, whoever is in power next week will not be obliged to start with a virtually blank sheet as we had to do in 1972.

As is well known, the subject of foreign investment is one that can excite strong passions, particularly in developing countries. At one extreme stand those who see external investment as the source of all economic progress, a life-giving stream of capital and technical know-how which will create jobs, earn foreign exchange, and in due course enable the developing nation to catch up with the industrialised countries.

At the other extreme are those who see it as the root of all evil, enabling rich and unscrupulous foreigners to exploit the nation’s resources and labour and sweeping the country away from the paths of true development.

In Papua New Guinea there has been plenty of emotional debate about foreign investment, but what I think is perhaps more important is that there also has been a good deal of sober thought about it.

I myself don’t think there is much to be gained by taking up a “pro” or “anti” position towards foreign investment as such. The real questions are whether it can play a useful part in the achievementof national goals, and if so in what areas and under what conditions. I should perhaps point out that the encouragement of foreign investment in itself is not a national goal. From a national point of view it can only be a means, and not an end.

It seems to me that the best way of working out how to treat foreign investment is to begin by getting it clear in your mind what kinds of investment you are looking for, and why. After that, it should be relatively straightforward to work out what you have to do to achieve your objective.

So far as the Government of Papua New Guinea is concerned, our analysis of what was necessary to achieve our national goals has convinced us that there are some kinds of outside investment we definitely want, some kinds we definitely don't want, and an intermediate area where we may or may not want investment, depending on a variety of factors.

One very important area in which we definitely want investment is that of major natural resource development. As a country that still depends on external aid to balance its budget, and one that is also rich in resource potential, we do not have the option of refusing to develop any of that potential while continuing to accpet hand-outs from other countries. In theory, we have the option of making huge cuts in our public expenditure to bring it down to what we could afford with the revenues we could expect if there is not major resource development. But, in practice, I have not noticed any politicians in the last few months calling for massive reductions in expenditure on roads, education, health care ... politicians aim to survive.

Out objective in financial policy has to be to make steady progress towards much greater self-reliance—otherwise political independence makes little sense.

We can’t achieve this overnight. In fact, given our historical situation, it is likely to take decades rather than years. But that, nevertheless, is the road along which we must travel. And the only way in which we can make major additions to our revenues is to develop some of the resources that nature has endowed us with.

Further to that, we are aware that to develop these resources we need outside capital, know-how, and market connections. It follows that we definitely need outside investment in some large natural resource projects.

That is one of the most important starting points for our thinking. But another, equally important, is the reason why we want this development. We want it, essentially, to provide us with Government revenue and foreign currency. We don’t want it, except incidentally, to provide employment or to generate directly additional economic activity. We know that there will be some benefits of these kinds from major resource projects, but they will be relatively small in relation to the amount of capital required.

The outline of the Government’s policies on major resource investment follows logically from these two starting points. Our policies must be designed in such a way that outside investors can obtain the reasonable rate of return they expect before they will commit themselves to making large investments. Equally, they must be designed so that the nation receives an adequate price or rent for its resources. And since the main aim of this form of development is to generate revenue, the nation is likely to receive the greater part of its price or rent in the form of taxation.

These two principles, a reasonable rate of return to the investor and a reasonable price to the nation, have guided the Government in working out its policies on major resource development over the past five years. The process began when we renegotiated the Bougainville Copper Agreement, having realised on taking office that the old agreement did not provide the nation with an adequate revenue from the very large gross profits which the resource was capable of generating at times of high world copper prices. It was continued with our negotiation of the terms under which the Ok Tedi copper prospect will be developed if construction of a mine proves technically and economically feasible. The same principles have been embodied in the legislation passed by Parliament covering terms for petroleum and gas exploration.

Practically, the way in which we have given effect to our principles in terms of detailed provisions is by making the relative shares of the total return from a project which go to investors and to the nation depend on the level of total rate of return. If the overall rate of return on the project is low, the investor gets a relatively large slice of the total so that he can still get his reasonable return. If the rate of return is high, the Government gets a relatively large slice because there is more left over after the investor has had his reasonable return.

No doubt many of you here are familiar with the details of the relevant legislation and agreements. Other speakers here today will have more to say on these matters. For my own part I feel pretty confident that we are on the right lines in that our way of doing things can provide for the reasonable expectations of both host country and foreign investor.

We have devoted a great deal of work to this area of major resource development because the consequences of failure to establish good policies in this area are likely to be disastrous, whether in the form of failure to develop our resources or of selling them too cheaply with the certainty of political backlash at some future time. But of course this type of investment, although the most important in financial terms, is by no means the only kind that Papua New Guinea is interested in receiving or that outside investors might be interested in providing.

Our attitude towards other types of outside investment, resource development or processing, in manufacturing whether for the domestic market or for export, in the commercial and service sector, is basically a simple one. We want it. But in the case of any investment that is proposed, we have to satisfy ourselves on two grounds: that it really is in the country’s interest, and that it will not pre-empt opportunities which our own nationals would be able to take up.

It was in order to provide itself with machinery to satisfy itself on these two counts that the Government established the National Investment and Development Authority as a body to screen proposals. The need as we saw it was to strike a balance – to provide for enough supervision and regulation so that the country’s interests could be protected and seen to be protected, without allowing the flow of investment to become bogged down in unnecessary bureaucracy. It was an entirely new exercise, and no doubt we have not always succeeded in achieving the right balance. But in one form or other it is a necessary exercise, and with growing experience I’m sure we will succeed in smoothing out whatever wrinkles may remain.

I see from the programme today that you will have the opportunity to discuss policy issues in relation to foreign investment policy in the manufacturing and service sectors and the options open to the Government in further developing its policies on foreign investment in these sectors. It’s not my job in this short talk to go into these issues in any detail, and I propose to confine myself to a few general remarks.

Import replacement, if carried out on an economic basis, creates additional income within the country. It is therefore desirable, and I myself have always been a strong advocate of the right kind of import replacement. However, there are serious dangers, particularly for a small country like ours with a limited domestic market.

It would be easy to arrange for the establishment of a number of manufacturing industries, to replace imports, but unless we are careful in the matter of the incentives that should properly be offered, whether in the form of protection of one sort or another or in fiscal concessions, the cost of establishing these industries could very well be higher than the benefit. If our consumers are obliged to pay substantially higher prices for locally made goods, or if our public revenues are seriously diminished, then all we are doing is to transfer income from the many to the few, with a net loss to the community as a whole.

That is one important reason why the Government has to exercise care in screening foreign investment proposals. I would be particularly interested to hear comments or questions on these issues. But meanwhile, since today’s gathering includes many representatives of the private sector I would like to make an appeal to private business in Papua New Guinea to adopt a more positive attitude to new investment. The justification of private or free enterprise is that it serves the community as a whole by taking initiatives and being willing to incur risks. Unless it performs these functions it has no obvious right to the profit it derives from the community. What I am saying is that free enterprise must be enterprising if it is to remain free.

One area where I hope the private sector will do very much more than in the past is in the promotion of local products. This seems to me a necessary part of national development – that Papua New Guineans should drink local tea and coffee, and eat local fish, rather than imported brands. I believe this is an area where the private sector rather than the Government must take the lead.

More generally, I would like to see private business move right away from the attitude that new investment must depend on negotiating special concessions from the Government. Such a negative frame of mind is bad for the country, and, in the long run, for private enterprise itself. Business, and particularly large businesses, that operate in this country have a responsibility to seek out new opportunities as actively as they can and to compete vigorously in the market place, both domestic and external.They have a duty, in short, to make the greatest and most positive contribution they can to the development of the nation. And in the last analysis, as well as being their duty this is their only justification.

Five years ago, in 1972, it was understandable that business should take a somewhat cautious approach towards the future. The new Government had not fully defined its policies and objectives. For this and other reasons the economic outlook was unclear. Then, beginning about the middle of 1974, the world entered a period of considerable economic difficulty.

I do not believe that there are now any reasons for unusual caution. The Government has shown by its actions that it is determined to maintain economic stability and capable of doing so - and it is this, far more than a battery of special concessions, that investors can legitimately insist on. Today, Papua New Guinea has a strong and stable currency. It has a healthy balance of payments, and there are institutions, such as stabilisation funds, which will protect the balance of payments against temporary downswings in export prices. Because it has these things, it is able to pursue a liberal policy on the remittance of foreign exchange.

We have followed a prudent and responsible course of fiscal management in each of five annual Budgets. We have negotiated financial arrangements with Australia which give insurance against the financial shocks that might have arisen from a sharp reduction of aid from that country. We have succeeded in protecting the domestic price level and keeping inflation down to a very modest rate. This in turn has allowed us to enter on a period of wage stability and industrial peace.

By any reckoning, these are substantial achievements in the field of economic management. The first thing any businessman or investor looks at is the track record, and ours is there for all to see.

The economic outlook over the next few years, as I see it, is for steady, unspectacular but worthwhile growth. The Government itself, at least so long as I and my party are members of it, will continue to lay heavy stress on fiscal prudence. Within that framework our projections suggest that a modest but appreciable increase in real Government spending should be possible year by year. We can also look forward to an increase in physical production of export crops by smallholders, and assuming stable commodity prices in real terms over a period of years, this will be reflected in some further increase in real consumption.

The underlying conditions for a reasonable measure of economic growth are therefore present. But the size of that growth, and the speed with which it comes about, depend to a substantial degree on what happens to investment. I leave aside major projects such as Ok Tedi, or the possibility of striking oil. The assumptions on which I am talking at this point do not include the establishment of any major new resource projects. But even without these the opportunities are there.I might mention, incidentally, that the trade arrangements we have negotiated with Australia must surely provide exciting opportunities for wide-awake investors.

I said earlier that there are some forms of outside investment we don’t want.As the Government of Papua New Guinea our first responsibility is to the nationals of this country, and we would not be carrying out our duty if we allowed foreigners to operate freely in areas where nationals are able to do the job. Restricted areas are laid down in the National Investment Priorities Schedule, and at the same time the Government has taken steps, through such measures as a tax holiday and preferential access to certain types of credit, to ensure that national companies operating in these fields will be adequately capitalised.

This preference for nationals is in no way a threat to outside investors, since there remain wide areas where national businesses are not in a position to operate.

My message to this seminar, in brief, is that the work of laying the foundations has very largely been done, and the time has come to build.I hope that the Government will continue to listen to the views of the private sector and respond to its reasonable requests. But as an independent nation, Papua New Guinea needs a vigorous and independent private sector, one that thinks dynamically and looks ahead. So far as private investment is concerned, the job of the Government is to set the right framework and clear the ground. The actual task of construction belongs to the private sector itself.

SEMINAR ON FOREIGN INVESTMENT POLICY - AUGUST 3, 1977

PROBLEMS CONFRONTED BY INVESTORS WHO OPERATE IN THE MANUFACTURING AND SERVICE SECTORS.

J J SEETO

R ELIAS

MELANESIAN SOAP PRODUCTS PTY LTD

INTRODUCTION

This paper attempts to put forward an account of the problems confronting an investor in the manufacturing and service sectors. Experience of these problems is based on the manufacture of Biscuits and Soap products, hence limited, however since these problems are very general in nature, it can be argued that all manufacturing ventures in Papua New Guinea have the same basic problems.

It is not intended to comment or examine the procedures adopted by the authorities in encouraging investment in the manufacturing and service industry. As yet, the Government has not spelt out its thinking as far as investment is concerned in this sector.

To date foreign investment has been openly encouraged. This "open policy" or attitude towards foreign investment does not preclude investors from investing in manufacturing ventures.

An industrial base developed at two levels -

(a) Processing and manufacturing of intermediate products e.g coconut oil, oil palm and timber. This group can be classified as export orientated and have been established to provide a source of cheap raw materials which could capture attractive prices on world markets. If prices are depressed on the world market, contracts with overseas consumers of these goods, can be negotiated on reasonable terms.

(b) Manufacturing of consumer goods - mainly for the domestic market. These are import replacement orientated.

There is a small scale modern industrial base which has been built up over the years. To date investors* in these manufacturing companies that operate in PNG are those who hold stocks of their parent companies overseas. To this extent it would be appropriate to say that most companies in the manufacturing and service sectors are subsidiaries of their overseas parent companies, or if not, subsidiaries back by an overseas company,

*An investor is defined as a stock holder of the common stocks of a manufacturing company. This means that most of the investors in manufacturing companies in PNG are parent overseas companies on one hand, and on the other, small domestic investors, individuals, family groups or private companies.

other than processing basic natural resources to intermediate products for overseas markets, manufacturing, especially of final consumer goods is motivated by the need to replace imports.Problems faced by overseas subsidiary companies, and local companies are similar but perhaps some what more acute for the domestic investor, who has to overcome the normal market barriers and existing consumer resistance towards new products.

PROBLEMS CONFRONTING THE INVESTOR

PNG domestic market, approximately 2.8 million people, is small compared to other developing countries and cannot support a large industrial base. The restricted market size demands of the private investor, a plant capacity that minimises his risks and maximises the potential gain on his investment. The small domestic market and limited plant capacity in turn restricts the size of the operation which adds to the cost of the product.

1. GEOGRAPHICAL LOCATION OF MARKET CENTRES

Lae has developed as the most focal point for purposes of distribution and manufacturing. Many companies have established themselves in Lae because Lae is centrally located and is within easy access by road, sea or air to many areas. Cost of transportation by any of these means of transport is relatively high. Those goods which are produced with raw material components that have been imported will incorporate in their prices, a double freight cost. Because of the wide geographical distribution of major market centres, costs of servicing these market areas would also add considerably to the cost of the goods.

In addition to the smallness of the market, the manufacturer is faced with a market with a humble level of purchasing power.Town dwellers, mostly wage income earners employed in the service or manufacturing industry would possess the necessary level of consumption needed to support manufacturing. However, an increase of wage income level would necessarily be an increase in the cost of labour, hence a tendency to force return on investment down. If the manufacturer wants to maintain the same level of return, he would have to increase the price. This will have the following effect on the product -

(a) less competitive against overseas competitors,

(b) nil improvement on the welfare of the community.

An overseas subsidiary company and a local manufacturer would equally face the same problems. The parent company of a subsidiary has had the market to itself initially, thus its subsidiary will inherit a market already established. It will not have to compete with its parent company. Whereas the local manufacturer <u>does</u> have to penetrate the market which overseas companies have an established hold.

2. RAW MATERIALS

The components of finished products are those basic materials used in its manufacture. In the manufacture of Biscuits and Soap in PNG raw materials are drawn both locally and from overseas, however, all necessary ingredients have to be imported. A local manufacturer of Biscuits in PNG would obtain flour at world export prices, presently running at 25 - 30% above the Australian domestic price* which is available to a competitor. On the other hand, thos domestic price available in Australia could possibly be transmitted to a subsidiary company in PNG. A domestic manufacturer as much as an overseas subsidiary has to pay the freight from Australia to the PNG port and later the freight of finished goods out of point of processing.

A great deal of raw materials could be drawn locally.The present government expects local manufacturers to use available local raw materials, which they have done. But current high world prices for the same commodities have rendered these materials uneconomical. In spite of the Government's expectations from the local manufacturer, there is no clear Policy Guidelines towards pricing of these raw materials. A domestic manufacturer would draw on these raw materials on world prices. There is a need for a domestic price that will encourage the manufacturer to utilise these available resources.

* The Minister for Finance, Mr Julius Chan, warned in his Budget speech on 25th September, 1974 of possible malpractices involving under-statement of profit caused by overpricing of imports and underpricing of exports. News Release No. 1426, p4.

3.PRODUCTION PROBLEMS

A newly established manufacturing concern will initially experience the following problems -

(a) Problems of producing a suitable product that is equal or if not better in quality than similar imported products.

(b) Produce a suitable product commensurate with the standard of living within the country. Develop a product which will improve the standard of living of the community. If raw materials were locally available, at a competitive price, this saving could be passed onto the consumer.

(c) Local manufacturing companies are required to be labour intensive, which adds to the cost of the item. In PNG labour intensive mode of productionis more expensive than mechanical means of production.

(d) Low volume of production because of the relative size of the market and a lack of sufficent purchasing power of the community.

(e) Absenteeism is a problem commonly experienced in companies in PNG. This is more common among unskilled employees.

(f) Breakdown of specialised machinery and non-availablity of parts

(g) Relative high wastage due to the non-availability of market for by-products

(h) Training of key personnel in the process of production is a costly business. Uncertainty of retaining trained personnel is a constant problem for the management.

4.MANAGEMENT AND TECHNICAL KNOW-HOW

A local manufacturer would tend to have the following problems -

(a) Lack of sufficient financial backing to withstand adverse market conditions. This is essential during the initial period.

(b) Lack of back-up expertise which would be available to an overseas subsidiary company.

(c) Lack of skilled and experienced personnel.

(d) Lack of back-up repairs and maintenance services.

(e) Uncertainty about shipping plus the normal shipping problems makes the manufacturer tie up more than necessary capital in inventory.

A local manufacturer is faced with the additional problem of high costs of training and retaining skilled labour. Initially, turnover of skilled personnel tends to be high and this would be common to all manufacturing areas.

Above the factory level, the general lack of expertise within the country has lead to many unnecessary delays which could be quite detrimental to an infant industry. outside the company -

(a)Government Departments lack the necessary manpower and expertise badly needed to service the private sector.

(b)Financial institutions may not be well versed with the complex requirements of a local investor. This is particularly so for a domestic investor compared to an overseas subsidiary whose parent company's standing may be sufficient to procure any necessary bank finance, that may be required.

Import replacement and export orientated manufacturing concerns in many Asian countries, receive substantial assistance from their Government. In PNG this is not uniformly applied. Some companies tend to qualify for such assistance from the Government more readily than others.Governments have available to it the following form of assistance to the manufacturing industry -

(a)Protective tariff of industry as opposed to revenue raising.

(b)Quantitative restriction using quotas or licensing.

(c) Tax incentive via a Pioneer Certificate.

The apparent absence of a uniform type of encouragement either in a form of quantitative restriction or tariff protection is sufficient indication of the lack of encouragement to the manufacturing sector. There is a high tariff on beverages but this was not designed to protect the industry - it was a means of raising revenue. The writers cannot see any coherent application of the above methods of assistance to manufacturing industries.

Pioneer status as a form of tax encouragement to pioneer industries is applicable only if a company is making a profit, and this is not easy in the initial stages. Capital intensive companies operating within a limited market such as that of PNG would not in the early years be making reasonable return on investment. In fact, the firms would normally have a deficit budget for at least the first few years.

Some manufacturers only cater for a small number of clients and to this extent have no problems in marketing their products. Initially their products would not be competitive with cheaper imports, however, once their products are accepted on the market, this problem would be resolved. Availability of the goods is perhaps the best asset for all manufacturers in PNG.

5. MARKETING

The marketing problem in PNG is one of choice of whom the manufacturer ought to supply. Normally, the manufacturer is required by tradition to sell to the Wholesaler. However, as the domestic market is so small, in certain areas it pays for the retailer with the purchasing power to buy direct from the manufacturer.

If the retailer buys direct from the manufacturer, the wholesaler will withhold his support from the local manufacturer. The wholesaler and retailer alike are concerned about how much margin they can mark up. This state of conflict leaves the manufacturer with the task of having to convince the final consumers that his product is just as good if not better than similar imported products.

In the case of soap, being a price controlled item, a retailer who buys from the wholesaler would be cutting his own margin down by 12 ½% whereas he could mark up 25% by buying direct.

Traditional use of certain types of products or Brand would normally add to the resistance in phasing in a new product onto the market.

Being locally produced, the consumer expects to pay less for the same quality products. This is an ill conceived expectation for the reasons already outlined above.

Merchandising in PNG is an expensive exercise. An investor would need the necessary commercial back-ups be associated services such as transportation - sea, road and air.

A large proportion of the consumers cannot be easily services due to lack of roads and other transportation services such as shipping. Shipping to many small areas is uneconomical. Airfreight is costly to the consumer who eventually would have to pay the price.

6. EMPLOYMENT IN MANUFACTURING AND SERVICE SECTOR

There are high expectations from both the public seeking job opportunities in urban areas where most of the manufacturing concerns operate. The growth of manufacturing in few areas has encouraged a movement of job seekers from the rural areas to the urban centres, coupled with this, population drift to urban areas, is the increasing output of job seekers finishing from schools and other educational institutions. Problems of unemployment in developing countries tend to have a positive correlation to the growth of the industrial base. The higher the growth of the modern industrial sector the higher is the level of urban unemployment. Manufacturing industries are expected to contribute towards the solution of unemployment problems, by labour intensive techniques. Increases in wages add to the cost of production. As a result, intensive manufacturing industries suffer under these circumstances and the manufacturer is induced to adopt more capital intensive techniques. Employment expansion which should be a by-product of general economic expansion is not attained. Lewis observed this and he said -

"One disturbing factor must be set against the high rate of growth of output and income ... namely, the rising levels of unemployment in the under developed countries. The phenomenon is unexpected, since rapid and high investment ought not to increase unemployment but reduce it."

SUMMARY

PNG market being small as it is, and further restricted by a low level of purchasing power is very costly to service.

Problems confronted by investors in manufacturing in PNG are similar to those in other developing countries. Domestic investor without assistance finds these problems more acute as compared to an investor who holds stocks of an overseas parent company.

Unemployment is a positive function of two variables -

(a) Increase in urban wages,

(b) Growth in the manufacturing sector.

SPEECH FOR INSTITUTE OF NATIONAL AFFAIRS SEMINAR ON FOREIGN INVESTMENT

"GOVERNMENT THINKING ON INVESTMENT IN EXTRACTIVE INDUSTRIES"

When I was first asked to speak to you today about "Present Government thinking on extractive industry investment", two or three problems immediately came to mind. Firstly, how could I outline the present Government's thinking on investment in the extractive industries on the eve of the changeover in Government without being presumptious about future changes in policies.(Here I must digress a little to explain that although I regard timber as an "extractive" industry, forestry falls within the scope of another Department's operation and so I will confine myself to those that do). Secondly, I was puzzled about how I should approach the topic. Fortunately, our current mineral policy enjoys such broad bi-partisan support that any comments made today would probably still be applicable after 9th August. As to the approach I should adopt, I decided that the best thing to do would be to outline the broad motivations behind our thinking without going unnecessarily into either the mechanics of administration or into past history of the development of policies.

Having said this, and prepared myself along these lines, it occurred to me that what new foreign investors in developing countries may be concerned about is not where policy stands at present, but rather the direction and pace at which it may be changing. We in government appreciate this anxiety with future uncertainties and while nobody can guarantee tomorrow, I can say with an "insider's" certainty that we see the future of minerals policy as evolutionary not revolutionary. In fact, we so believe that our present policies are fundamentally fair and conceptually defensable, that we will be working, over the upcoming years, to demonstrate that they represent a workable compromise between investor risk on the one hand, and national objectives on the other.

The cornerstone of Papua New Guinea's resource policy was first outlined by the then Chief Minister of Papua New Guinea in March 1974 in an address to the Australian Institute of Directors. To quote Mr Somare –

"Our most important basic principle is that these resources belong to the people of Papua New Guinea. It is up to our people, through their Government, to choose how and when these resources will be developed."

The Chief Minister then went on to say –

"...I believe that foreign companies would be satisfied with a reasonable return on investments and should not claim absolute right to gigantic profits that are really produced by the earth and water of Papua New Guinea."

There is one other document from which I would like to quote and that is the Constitution itself, which was adopted some 18 months later. The Fourth National Goals and Directive Principles states –

"We declare our fourth goal to be for Papua New Guinea's natural resources ... to be ... used for the collective benefit of us all ..."

I quote from the Constitution merely to re-emphasise that the "resources belong to the people."

Since 1974, the Papua New Guinea Government has successfully refined these concepts of public ownership and reasonable return into a mineral policy which is both workable and conceptually consistent over the long term. To say that we have been entirely successful in producing a perfect policy would of course be absurd. What we have accomplished, I feel, is a series of policy approximations which translate the essence of the Somare ideas into a more or less practical policy framework. Our policy will not be attractive to all investors and, indeed, we have already seen evidence of this but we believe it has many advantages over approaches adopted elsewhere.

I would like, at this point, to say that the bi-partisan acceptance of the Government's policies has been amply demonstrated by the fact that legislation on mining and petroleum passed through last Parliament amendments only on minor points. Additionally, the fact that there has been an increase in the number of enquiries before and during the recent national elections and the high level of actual exploration work is indicative of the acceptance of our policies by large investors from overseas.

I know that these days it is common for developing countries to base their mineral policy on the admittedly vague concept of "a fair or equitable return to investors". I would be less than candid if I did not admit that the definition of such a phrase is now always the same and, from the investors viewpoint, encompasses a range of both sins and blessings. Early on in our mineral thinking, it became clear that it was necessary to arrive at a practical operational definition which could be understood, on both sides of the bargaining table. We also appreciated that inherent in any such definition must be firm limits on government's discretionary powers. As a bureaucrat I can assure you that the toughest thing for any government official is to give up his discretionary power. But in large measure, this is what we did, and we believe that this is a fundamental difference between our fiscal attitude toward mining and that taken by many other countries.

To be sure there is no such thing as an iron-clad contract when dealing with a sovereign state, but this applies - as I'm sure you are aware - equally as well to Canada and Australia as to Papua New Guinea.But, at the very least, we won't ask the investor to place: an unconditional trust in a unilateral interpretation of what "fair and equitable return" really means. We are willing to commit early to long term comprehensive contracts with investors which spell out their rights, security of tenure, and financial obligations. In fact, we have gone further than this in recent oil and copper agreements, and have actually given certain critical portions of the agreements the force of statutory law.

As a young country, we cannot point to a long history of stable relationships with mineral investors, but our philosophy is to make whatever assurances we can within the framework of a generally stated legal position. As we mature and gain experience, I think it is safe to anticipate that our policy will move increasingly away from the special, negotiated type agreement, towards a comprehensive statutory system. This movement is already evident in the recent publication of a white paper on financial policy toward mining which will eventually be submitted to Parliament as new legislation. Let me pause here, and summarise what I think are important fundamental concepts in our approach in mineral development. Our philosophy is one of –

1.Limited discretion

2.Comprehensive long term commitments built on operational definition; and

3.Movement toward a statutorially defined mineral policy.

With this philosophy in mind, I would like to make a few comments about the elements of our fiscal scheme, keeping in mind the Government stated policy that investors should be offered the opportunity to earn a reasonable return on their investment but that a large share of income in excess of the reasonable return should accrue to Papua New Guinea as the owner of mineral resources.

In the mineral resources area we are dealing with the extraction of an exhaustible resource. As stated earlier, the owners of that resource are the people of Papua New Guinea. Miners who extract the minerals should pay for the removal of the minerals. Our policies seek to extract a fair price for the minerals in such a way as to not add to considerable risks already involved in mining. The Government has developed mechanisms for implementing its general statements in concrete form.

It is important to view the various elements in our financial policy as part of a package rather than in isolation from one another. At the heart of the package is the traditional method of business financial analysis - the discounted cash flow. But experience over the last 6 or 7 years suggests that any measure of profitability including discounted cash flow, may prove inadequate unless related to some inflationary measure. It is here that our operational definitions become most refined in that we attempt, at least conceptually, to define a real rate of return on the investment risks being assumed by the mining company.

Thus, in assessing the discounted cash flow results we think of two elements, a risk element to the miner for investing his entrepreneural skills, energy, and business expertise, plus an inflation hedged return on capital. In practice this means that a fair rate of return is defined as a fixed percentage addition to the New York rate for corporate bonds. The risk premium in this definition is, of course, the percentage addition while the bond rate reflects a return to investment capital. Since the bond rate fluctuates with general inflationary levels we feel that it provides an automatic adjustment for inflation, in our view, such a formulation is a major improvement over agreements tied solely to profitability calculations which recognise neither risksnor inflation. With a target profitability now defined we can structure the individual fiscal elements. Our principal mechanism to ensure that windfall profits accrue to the people of Papua New Guinea is the additional profits tax which is a tax charged on cash flow in excess of the target return on total funds.

For those of you like me who are not economists I should explain what this means in simple terms. If an investor has earned a discounted cash flow return of 20% this means that he has earned the same amount of cash from his investment as he would have done if he had invested his money in a bank which paid him a 20% rate of interest, continued to earn 20% interest in each year to the end of the investment and then withdrew his original investment from the Bank.So when I speak of a DCF return of 20% it means the investor has returned a 20% rate of interest and got his capital back. In the case of the Ok Tedi project it is only after the investment earned this return of 20% and got his capital back that an additional profits tax is payable. I think you will agree with me that an investment would be regarded as very much a success before any additional tax payments are payable. After a reasonable return on an investment has been earned it is only fair that extra income should be paid to the owner of the resource. Therefore, the rate of additional profits tax are set at a moderately high rate of 70% of cash flow. The advantage of this system of taxation is that it cannot increase the risks of the project, as additional tax is not paid until the project has proven to be a success and since our normal taxes are very modest, the system encourages marginal mines. Further in contrast to tax schemes in other developing countries, our tax system places no absolute level on the profits of the investor. We want to maintain a considerable incentive for investors to conduct efficient operations in PNG and are therefore willing to treat businessmen for what they, in fact, are - risk takers and innovators - not public utilities.

In summarising, I would like to highlight a few points about the implication of our tax policy.

First, the investor is assured that the tax system will not add to the risks of the project nor will it reduce the likelihood of the investor earning a fair return. Secondly, the system provides fbr an automatic sharing of the mine benefits based on actual profitability. Thirdly, and perhaps most important, the system is highly flexible with tax shares automatically adjusting to changed circumstances - so the system is stable.

To make the tax bill more attractive, we have evolved schemes enabling the investor to take advantage of accelerated depreciation provisions during these critical early years of a new project when the risk is at its maximum. The effect of this taxation scheme is to significantly soften up the front end of major projects.

There are, of course, other aspects to our fiscal package beside the basic taxation formulas. These elements are a token royalty on sales revenue which accrues to the provincial government, and equity participation by the government. In recognition that any imposts on gross – sale – receipts before – deductions is extremely important to overall project economics, we have sought to keep this element to a minimum of 1½%. In fact, within the overall economy this 1½% royalty is really more a revenue sharing scheme for funnelling money back to regional authorities than a revenue raising tool.

On equity, our policy has been restricted to an ownership of 20-25%. Here again, we are driven as much by non financial as by financial motives. Our experiences at Bougainville suggests that only through direct representation of the Board of Directors can Government and company come to a full appreciation of each others viewpoints. It is essential that neither party present the other with fait accompli type decisions if harmonious relations are to be maintained. We would like to call it the Melanesian way, but, in fact, it is simply good business.

Before concluding I should make mention of two general economic policies which, while not restricted solely to mining, do play a significant role in decisions on mining economics. These policies are foreign exchange and dividend with-holding tax, these areas are clearly not the province of my department – I'm sure there are others in this room with more expertise than myself. However, since the effects of these policies are more important to large capital intensive projects like mines than to smaller activities, they should not be ignored.

Our policy on foreign exchange revolves around investor assurances of currency convertibility. These assurances guarantee that the investor will be free to convert kina into foreign exchange to the extent necessary for the efficient conduct of operations, for loan repayments and for the remittance of dividends to foreign shareholders. In addition, offshore funds can be held to the extent necessary to meet 3 months forward obligations for the above purposes. We feel that these assurances are adequate to ensure that any mining project in Papua New Guinea will not be impeded by a lack of foreign exchange. Of course, additional foreign exchange can be obtained through normal application and approval procedures of the Central Bank.

On divident withholding tax, we, like many other nations would like to see profits obtained from natural resource development retained and reinvested within the country. While our method of doing this might be described as a negative incentive, we have, I feel, avoided imposts which are out of line with world practice.

Let me conclude by quickly summarising what I feel are the major considerations in our fiscal package.

1.Our approach is based on standard commonly used business analysis techniques.

2.We try to give adequate consideration to the critical problems of inflation and risk.

3.Our agreements are built around operational definitions of important concepts and we try to avoid large areas of discretional powers.

4.We are moving toward a generally stated comprehensive fiscal system for the mineral sector which will minimise the need for special agreement

5.Our tax system is designed to encourage marginal mines and ensure that the majority of windfall profits accrue to the people of Papua New Guinea.

6. We do not view mining enterprises as public ulitities and do not put absolute limits on profits.

7. We offer foreign exchange assurances, a firm policy on equity participation, and a desire for amenable relations.

I realise that my talk may not have covered all of the areas that need to be discussed. The Government has a white paper prepared in draft form relating to financial policy on mining.

This is not at present for circulation, but I am sure officials of the Government would be pleased to discuss aspects if anyone wishes to know more about our policies in this area.

Thank you.

BILL LAWRENCE

Secretary for Natural Resources

Delivered on his behalf by Mr Nigel Agonia)

PAPER PRESENTED TO THE INSTITUTE OF NATIONAL AFFAIRS SEMINAR ON FOREIGN INVESTMENT POLICY IN PNG - 3 AUGUST, 1977

SUBJECT:

A PERSONAL REVIEW OF THE BASIC APPROACHES NECESSARY TO ATTRACT FOREIGN INVESTMENT UNDER TERMS WHICH ARE ACCEPTABLE TO ALL PARTIES, THE CURRENT POSITION, WHAT NEEDS TO BE DONE AND WHAT CAN OR COULD BE DONE.

CONTENTS:

INTRODUCTION

Originally it was intended that Mr J Auna of NIDA would be speaking at this time and would be concentrating basically on the past problems and future development of NIDA. As Mr Auna is not available to give his talk, I have been asked to talk in his place. It is not practical or proper for me to try to give the same talk that Mr Auna would have done and nor do I intend to. However, the past and future role of NIDA must be considered in this talk.

It is a great pity that representatives of NIDA cannot be present at this seminar to listen to and exchange ideas with representatives of the private sector and government who can, particularly in the initial stages, influence investment decision. Potential new investors tend to talk to solicitors, accountants and existing investors about the investment climate, current economic and political conditions and the prospects for future investment.

As a speaker, I am speaking as a counsellor of the Institute of National Affairs and not in my capacity as President of the Employers Federation, nor in my business capacity as the Managing Director of W R Carpenter (PNG) Limited.However, my experience in both these roles has given me some experience of the vagaries and uncertainties of policies on foreign investment during the past three years or so, and of the different philosophies apparently preached by various advisers, most of whom have come and gone, on the subject of foreign investment.

It would appear from the outside that some of these advisers were neither committed to the prosperity of PNG as a whole nor to the wellbeing of the population of this country. In the private sector, particularly in those firms which have been involved over a period of years, we believe that we have for business, economic and social reasons, a greater commitment to the stability and growth of the wealth of PNG with its redistribution towards nationals than some of those who have in the past, been guiding or attempting to guide the foreign investment policies of the Government. I have been involved with commerce, agri-culture, agricultural manufacturing and the people of PNG for the last six years, during which period our Group has continued to reinvest a substantial proportion of profits in the country and to engage in further capital expenditure to the benefit both of ourselves and of PNG.

1. SOME BACKGROUND AND ATTITUDES ON FOREIGN INVESTMENT

Foreign investment means different things to different people, particularly in a country like PNG. Generally, the term is meant to describe investment by overseas interests but I suspect that in PNG this is not the only form of "foreign" investment in the eyes of the people. There is a growing regionalism and we now have Provincial Governments. Some of the statements made by various Groups would indicate for example, that the inhabitants of West New Britain regard investments in the Kimbe area by Tolais as "foreign", the Papuans regard New Guinea Highlanders' investment in Port Moresby as "foreign" and that Western Highlanders' regard Chimbu investment in Mount Hagen as "foreign". These investments may generally, at this stage be only on a small scale, for example trade stores, public transport, small holder plantations, but nevertheless, they are investments.

Some opponents of foreign or overseas investment seem to forget that the wealth of the USA was originally built on foreign investment, as was that of Australia and New Zealand. The recovery of Europe after the Second World War was to a significant degree due to overseas investment. It is also probably that those African countries which encouraged controlled foreign investment following independence are now, generally speaking, more prosperous than those which tried to "go it alone".

The fact that multi-nationals are now the subject of attack throughout the western world demonstrates that this foreign investment may originally have been badly controlled, but this does not change the fact that without investment the countries mentioned would probably have lower gross national income per head of population.

The current position in PNG with regard to foreign exchange earnings is that they are, to a large degree, earned by Companies which are foreign investors and that the bulk of direct taxation or other payments, or from their employees.

2. EXISTING GOVERNMENT POLICY

Three recent publications by Government instrumentalities have indicated the existing attitude to foreign investment. These are the PNG National Investment Strategy, published November 1976, the National Development Strategy, published October 1976 and the Third National Investment Priorities Schedule published January 1977.

The Government attitudes which are stated and elaborated on in these documents can best be summarised by quoting from the introduction to the Third National Investment Priorities Schedule. These quotations are verbatim, they are not full statements, but they are certainly not taken out of context –

– The Government of PNG recognises that foreign investment in many areas is of vital importance in developing the country's economy.

– The Government of PNG believes that foreign investment has a positive contribution to make in achieving the country's development aims, in bringing about increases in foreign exchange earnings, income and employment and in catering for the social and other needs of PNG.

Without new foreign investment projections indicate that –

– the growth in GNP would be substantially slowed down and may in fact, not grow at all

– the country would face growing balance of payments and revenue gaps leading to a sharp fall in Government spending, and

– unemployment would rise at a very rapid rate, causing considerable economic and social problems.

While stating that foreign investment is necessary, the Government also quite rightly states that it needs to be controlled and that it needs to be to the benefit of PNG and its people as a whole and that it must lead to the redistribution of benefits to the advantage of the people of PNG.

This need to redistribute the benefits of foreign investment to the advantage of the people of PNG is not in any way a matter of dispute. The National Investment Strategy states that "the purchase of equity in a foreign enterprise by the Government as a rule should not be designed as a mechanism to take a share in the profits". This can best be achieved by tax mechanisms of one type or another.

Direct National equity by private individuals or groups (in foreign enterprise) is another matter.It can be more difficult than government equity in that –

(a) National groups do not usually have the "assets" to contribute as their share of the equity whereas the government may well have,

(b) The same groups cannot usually finance the loans or working capital funds necessary to maintain their share of the total assets of the company.

There is evidence to suggest that "National" equity has been used some in cases more as a tool by existing foreign investors to retain control or at least the profits of a company within definition of a "National" company with the consequent advantages for tendering preferences etc.

The acquisition of shares in existing or new foreign investments by the Investment Corporation may be a better means of increasing the National participation, control and share of the benefits.

In discussing the basic principles of investment strategy, the strategy paper states that these principles are: a strong and healthy economy with sustained growth, the just equitable distribution of wealth and income and both the Government and private sector contributing to the fullest extent possible to achieve these aims. A strategy based on these principles is necessary to avoid the occurrence of either one of the following situations –

– a strong healthy economy with only a few people sharing in the rewards of this economy, or

– radical redistribution (of wealth) policies, which result in the collapse of the economy and make everyone poorer.

What is needed is an increase in the overall wealth of the country to the benefit of PNG’s nationals.

3. HOW TO ENCOURAGE AND ACHIEVE A DESIRABLE LEVEL OF FOREIGN INVESTMENT

It is essential that the desirability of foreign investment as indicated in recent publications, is accepted by all political parties, statutory authorities, the Public Service and the advisers to any of these bodies. Once it is accepted that controlled foreign investment is desirable, then this investment should no longer be a political matter, it is an economic and social matter and judgement should be made on this basis.

There are three broad approaches to attracting foreign investment, these are –

1.Creating and fostering a good investment climate,

2.Providing specific information on the investment opportunities available, 3.Providing where necessary, fiscal or other investment incentives.

Probably by far the most effective and least costly means of attracting foreign investment is by improving the country's investment climate. This can be achieved by minimising the risk, the uncertainty, the obstruction and the frustrations which can be associated with plans for new investment by firms not currently operating in PNG or further investment by firms who already operate in this country.

If PNG is to maximise the potential advantages and minimise the potential disadvantages associated with foreign investment, it should implement carefully formulated policy measures which will ensure that investors are still attracted to the country despite the fact that they are subject to government regulation and control. Such a policy should balance the need for sensible rules which can be adjusted for changing circumstances against the need for a policy which is sufficiently stable and certain to allow investors to plan for the medium and long term. The more risky and difficult the proposed venture, the greater the return on investment will have in order to entice an investor.

4. THE INVESTMENT CLIMATE

The present Government has established an excellent record of sound management of the economy by restricting national expenditure to levels which the country can afford and by maintaining the Kina as a hard currency.

PNG has adopted two approaches to budgeting Government expenditure, closer to what the country can afford. Firstly, additional domestic revenue has been raised by taking up the slack in the existing tax policies. Now that this has been achieved, there is a further need to extend the tax base to cover those self-employed cash earners and others who are not taxed effectively. Secondly, non-priority government expenditure has been restricted and some moves made to reorientate this expenditure from social and administrative services to developmental investments.

The Government has pursued a policy of national wage restraint combined with a degree of price control, both of which measures are aimed at reducing inflation and the level of imports. The Government by its economic actions has done much to avoid the scenario of a deficit balance of payments, devaluation, inflation, unsubstantiated wage increases and deficit financing.

However, although increases in national wages have been restrained, some of the hastily introduced conditions of service and industrial legislation has caused concern, if not alarm to existing overseas investors. Typical of this is the introduction of long service leave at very generous levels retrospective to 1966, without any allowance for investors to adjust for their outstanding commitments. In the industrial legislation area, it is also of concern to note that although employers may observe the conditions of an Award agreed to by both the unions and the Department of Labour, they may still be subject to making payments not provided by that Award.

In relation to the price control, which has certainly helped to control inflation, the mechanics does not seem to be flexible enough to react when it is necessary for prices to rise unless of course, these rises are due to increases in Government revenue.

As mentioned previously, the Government has now clarified its foreign investment policy which is basically sound. However, there have been some unfortunate aspects associated with the past implementation of foreign investment policy which have damaged the country's investment climate. Those who were in PNG at the time, will remember the fiasco of the PNG Canning Corporation, the uncertainties created by the dispute between Kennecott Copper and the Government and the hard position taken by the Government in its re-negotiations with Bougainville Copper Limited. The revised BCL Agreement was accepted by the Company at the time it was renegotiated, but it is probable that had those conditions been originally enforced, the project would never have gone ahead.

Such episodes are in the past and we believe that attitudes and policies have changed, but it is still not certain in many minds that NIDA is more committed to fostering new investment rather than policing the old.It should be remembered "quality investors are not easy to come by, especially for a newly independent developing country like PNG". These are not my words, but those of the Department of Labour, Commerce and Industry.

There has been lack of effective communication with the private sector but recently there have been indications that more constructive dialogue has developed between these two sectors, much of it initiated by government officers.

In PNG the safe-guarding of the interests of foreign investors is meant to be covered by official guarantees which are documented in the National Investment and Development Act. However, these are subject to changes in the laws of the country or changes in taxation or fiscal policies. While it is recognised that no Government can effectively bind its successors to an established course of action, every effort should be made to strengthen the guarantees presently offered so that they at least conform with the international norms of prompt and adequate compensation upon nationalisation or other forms of acquisition.It would bolster business confidence if PNG were to sign the Convention of Settlement of Investment Disputes, which has been drawn up under the auspices of the World Bank.

Relating to specific information on investment opportunities, it is intended to discuss this under the heading of the role of NIDA.

Investment incentives both fiscal and other are instruments of government policy which are designed to induce private investment or stimulate expansion of existing private investment. Such incentives can be justified only where they promote desirable investment which would otherwise not be forthcoming. PNG has apparently chosen to provide none or minimal fiscal incentives to foreign investors, although some government funds may be diverted to assist the developing of the private sector. In one publication, namely "*A Guide to foreign Investors on Agriculture Development Opportunities in PNG*" NIDA states categorically that "no tax holidays are offered as the Government feels that this encourages investors who are only interested in short-term development and exploit the resources in the tax holiday period". This indicates the frame of mind which believes that tax holidays are in themselves evil and will be themselves encourage undesirable investment. This must be a subjective opinion. There would seem to be very few potential foreign investors who could, starting from scratch, within a tax free period accumulate enough profits and relisable assets to make it worthwhile them operating for that period only.

Incentives should be considered particularly for employment creating and import replacement industries and the policy should be one of flexible incentives, possible with subsidies which can be scrutinised and reviewed annually. These are preferable to tariff protection which is at the expense of the final user. It is essential that incentives should not be granted which would attract permanently inefficient industry to the country.

The different types of incentives and the application of these is a complicated subject but each case should be considered on its own merits and the question should not be dismissed out of hand. On this subject, I would refer you to an article in the Post Courier on July 15th. This article by a naturalised Papua New Guinean who has been involved in the PNG timber industry for a considerable number of years compares the incentives available in Malaysia to foreign investors, including the timber industry, compared to the situation in PNG. These incentives include -

- pioneer status and tax exemption for a period of between 2 to 5 years,
- investments tax credits,
- labour utilisation relief,
- export incentives,
- import duty exemption on machines used for production.

As far as I know, none of these are available to foreign investors in the timber or any other industry within PNG.

5. THE ROLE OF NIDA

In the introduction to the Third National Investment Priorities Schedule, the role of NIDA is defined as follows

"The National Investment and Development Authority is the statutory body responsible for coordinating the promotion and regulation of private foreign investment in PNG. Government's intention when it established NIDA in 1974 was not to stifle initiative in new foreign investment projects, but rather to foster mutual understanding between the investor and government; to provide a better climate and more security for the investor on the one hand, and a re-assurance to Government about business behaviour on the other."

This definition is restrictive with the equal emphasis on regulation and indicates as does the paper on national investment strategy, that this body is long on planning, unmeasured on effort and very short on achievement. With the declared objectives of encouraging foreign investments, in the right areas under agreed conditions and with the proper controls, then NIDA's prime role should be to ensure that such foreign investment is achieved. In the introduction to the above Schedule, is a list of the aspects to which Government, and presumably NIDA, will give consideration. Once these aspects have been considered and agreement has been reached between NIDA and the investor or investors, why cannot NIDA be responsible for the successful implementation of this Agreement. One of the major roles of NIDA should be to minimise, if it cannot eliminate,the bureaucratic obstruction to foreign investment which exists in this country as in many others.

One justification for having a body such as NIDA is that it can streamline the bureaucratic process involved in government dealings with foreign investors. However, in PNG a foreign investor's application is evaluated by the NIDA Board which comprises the Departmental Heads of all the major government ministries concerned with foreign investment. Because these Board members are briefed by both their departmental staff and the NIDA secretariat, it can be argued that NIDA represents an extension of the bureaucratic procedures associated with investing in the country.

In addition to being screened by NIDA, most foreign investors require clearance from a number of other government authorities. For example, those investors contemplating foreign exchange transactions, require authority from the Bank of Papua New Guinea. Authority to acquire land necessitates a cumbersome tender process involving both the Land Board and the Department of Natural Resources. Permission to erect a building requires approval from the local Council Building Authority, the Office of Environment and Conservation, and the Department of Public Health.

While checks such as these are undoubtedly necessary to safeguard the interests of PNG it is probably that they could be streamlined without compromising their effectiveness. Any reduction in the official obstruction to investment will make the country more attractive to investors. Provided NIDA upgrades the professional quality of its secretariat, there will be considerable advantage in extending its powers in order to facilitate and extend its stated coordination role into one of finalisation.

If NIDA does not take over the role of obtaining clearance for a project for all levels, then the potential investor who may have limited knowledge of the Government and bureaucratic structure, is faced with a bewildering range of people and procedural obstacles which may involve, among others –

Government Ministers and their advisers

Government Public Servants

Statutory authorities and public utilities

Provincial Government Ministers.and their advisers

Provincial Public Servants

Local Councils

Traditional land owners.

There seem to be good reasons for NIDA to be responsible to a central body rather than to an individual government department. Why should it be basically respondible to any department, be it…

Labour Commerce and Industry

Natural Resources

Primary Industry

Transport

Finance

It should be a national body responsible to the NEC or perhaps the Prime Minister’s Department. If it is responsible to one sectional department, then this can and will cause friction with other sectional departments.

NIDA’s existing marketing approach should be considerably improved with the provision of more factual material in support of their promotions. To provide this information of course, NIDA must be sure of the facts which it is presenting. For example, reference is made to suitable land for the cultivation and processing of rice and sugar cane. It appears to be the same land for both crops and is NIDA in the position of stating categorically that nay or all of that land will be made available for the purpose outlined under suitable tenure as required.

It has been argued that one of the most important barriers to expansion of international business is poor market information, that is the lack of information on opportunities in new markets, on the particular needs of prospective customers, on existing and future demand and supply conditions for the product in question, on existing and potential competition, on factors affecting the supply of necessary inputs, and on possible channels of distribution, etc. In view of this consideration, it is suggested that the provision of such information could provide a very effective form of incentive for foreign investors.

Such information could be provided at little additional cost to the country if NIDA reorientated some of its information output from the existing emphasis on theoretical frameworks and strategies to specific factual information on the various resource, markets and infrastructure facilities available within the country. The Government needs to develop the cost, marketing and distribution data needed to identify specific projects for foreign investment. This implies gathering sufficient information to enable feasibility studies to be handed to prospective investors. Such data would be particularly valuable for the manufacturing and service sector because the required clarification of investment policy in this area can be achieved most effectively by reference to specific projects.

In summary, if NIDA can cast off its historically observed role as a policeman, a paper processor and a controller, it can, with adequate people and other resources and with a changing emphasis become an initiator and a successful instrument for the obtaining of the type of foreign investment which PNG requires and which it will accept.

The reasons for believing that NIDA should not involve itself to any degree with foreign investments and activities which existed at the time of NIDA's establishment are that these activities and their contribution to PNG can well be controlled by government departments, namely the Departments of

Trade

Labour Commerce and Industry

Finance

Primary Industry

or others which effect the activities of businesses within this country.

6. SUMMARY

- The Government of Papua New Guinea has agreed that a measure of controlled foreign investment is desirable, and various papers and publications have defined the areas in which investment is preferred.
- To date, the Government has provided a history of political and economic stability and financial responsibility.
- There are still some uncertainties in the minds of potential investors.
- Incentives should not be ignored but should be considered on their merits of each individual proposal.
- NIDA if properly directed and motivated can become the vehicle to achieve the foreign investment which the government requires rather than to prevent the type of foreign investment which the Government does not require.

Finally, although PNG is richly endowed with natural resources, it must compete with other countries for the limited expertise and financial resources available to develop these resources for the benefit of the people of PNG and that in any investment there must be positive benefits and security for both sides. For the last time I quote from the National Investment Strategy -

"As with the Government, the private sector will not be able to make its fullest contribution if policy towards it becomes unbalanced. Government cannot expect businesses to make very rapid changes to meet distribution (of wealth) policies and at the same time contribute to helping to build a strong and healthy economy. Businesses will not invest if distribution (of wealth) policies interfere to such an extent that they cannot get a return on that investment. In the same way uncertainty of policy might cause businesses to delay or withhold investment or new production plans. On the other hand, foreign businesses cannot expect a stable environment if they are not prepared to share the returns from economic growth with the country in which they operate."

M BENDALL

INSTITUTE OF NATIONAL AFFAIRS SEMINAR ON FOREIGN INVESTMENT POLICY 3RD AUGUST, 1977

EMERGING POLICY ISSUES ON FOREIGN INVESTMENT IN MANUFACTURING AND SERVICE SECTORS

Papua New Guinea is faced with policy-making towards foreign investment in its industrial and service sectors, at a time when industrialisation as a strategy for development has fallen into disrepute throughout the Third World. The reasons for this state of disrepute have less to do with industrialisation in itself than with the objectives of industrialisation often set by planners in developing countries themselves. The problem has been known for some years: I quote from a book published in 1970 (Planning Development, K Griffin and J Enos)

> "It seems that the benefits of industrialisation have not been as great in practice as is often claimed and hoped. The strategy for industrialisation most commonly adopted, namely, concentration on import substitution of consumer goods, has frequently neither saved foreign exchange nor contributed to real output. Errors in policy have been enormous and widespread ... What little evidence we have suggests that the consumer goods industries are prone to be inefficient. Intermediate and producer goods industries, on the other hand, appear less frequently to have negative value added."

Despite many years of comparatively rapid rates of growth of manufacturing output in Third World countries, these countries are very little nearer to the goal of self-reliance; problems of urban unemployment are, if anything, increasing, balance of payments problems are far from solution, and industrialisation does not appear to have brought an improvement in living standards for the mass of the population. For these reasons the trend of development strategy in Third World countries has been away from urban development and industrialisation, and towards rural development - under a variety of definitions - as far as domestic policy is concerned.

This has been coupled with a series of new international initiatives commonly summed up as the search for a new international economic order, comprising improved trading opportunities for Third World countries, commodity price stabilisation, and improved flows of aid from the developed industrial world to the developing world. As a matter of course, the role of foreign investment, usually taken to mean investment owned by firms based in the developed capitalist industrial world, has also come under scrutiny and criticism.

Papua New Guinea’s development strategy evolved independently of international developments, as a response to the problems of a newly independent state. It was, however, inevitably influenced by international thinking, and the approach that Papua New Guinea has adopted on many issues is entirely in accord with the search for equity in international economic relations. Papua New Guinea has opted for a strategy of rural development – meaning by this the increase of income-earning opportunities for the mass of the people living in rural areas. The emphasis is on opportunities for people to create income for themselves, rather than upon the supply of services and benefits from the government. Nevertheless, the demands of this strategy upon public expenditure are enormous – especially when we consider the lack of integration in Papua New Guinea’s internal economy, the infrastructure and communications requirements, and the relatively late start in the development process of most areas of the country. We have also to take into account that the majority of existing enterprises, both small and large, in manufacturing and service sectors of the economy are owned or controlled by non-nationals.

These considerations are foremost among the difficulties that face us; but the strategy adopted is the only one that can involve the majority of the population, and also makes the long-run welfare of Papua New Guineans the prime object of policy.

To pursue a coherent policy against this background, government has to break up its policy on investment into a number of component parts according to the type of investment, and also to the national objectives served by the investment. The National Development Strategy specified three groups.

Firstly, large scale extractive and natural resource-based industries; Secondly, medium and large scale investment in manufacturing and service activities; Thirdly, small scale rural and urban business activities.

Policies in the first of these areas have been discussed by an earlier speaker; these policies are now clear and well defined, and the objectives of policy in this area are geared mainly to the requirement for increased public revenues and fiscal self-reliance.

In the third area, small scale business, it is clear to all concerned that the promotion of these activities is in line with the National Development Strategy, and that certain costs will have to be incurred to promote these activities in the early years. A great deal of work remains to be done in the area of promotion, and we also have to take account of the fact that the majority of establishments sometimes classified as “foreign investments” lie in the small business area. As time goes on, government will have to pay increasing attention to the structure of activity in small business enterprises, with a view not only to its ownership, but also to the sectoral concentration of such activity (for example whether it is mainly in service industries, such as transport, or increasingly in vital areas such as food production), and redistributional effects of small scale business activity.

The principles of policy, however, in the second area, medium to large scale investment in manufacturing and service activities, are much more difficult to establish – I think this has been evident in the succession of documents that have been produced by the government, and in the continued discussion of the possible options open. In recent years the environment for discussion of this question has changed rapidly.

Not only has there been political independence, but there has also been the establishment of an independent monetary system, of national economic management, and of national institutions for the regulation of foreign investment. There has also been a considerable change in the economic climate. We have passed through, and perhaps not fully emerged from, a world wide recession. There has been enormous change in the structure of costs for industry both as the result of world wide inflation, and of radical (though, in my view, necessary) changes in the structure of wages and salaries in Papua New Guinea. For all these reasons investor attitudes, and policies of government, are still in the process of development - if not the state of flux that is sometimes suggested.

The Government has already made it clear that while the eighth national aim calls for government control and involvement in those sectors of the economy where control is necessary to achieve the desired kind of development, foreign investment remains both necessary and welcome for the development of Papua New Guinea. The role of the state is therefore interpreted positively, for the creation of what the Faber Report of 1972 recommended as "a mixed capitalist" economy pattern of development for Papua New Guinea. This positive approach is perhaps best exemplified first, by the conduct of a general economic policy, with the maintenance of an environment in which decisions could be made with reasonable confidence by all elements in the economy, and secondly by the government's clearly stated policy towards development in extractive industries - where the fiscal regime and other conditions have been carefully designed to fulfill national objectives, while providing all necessary incentive for the investor, and for the long term development of the sector in Papua New Guinea. We therefore start from this position, and suggest immediately that a sound government policy towards foreign investment in other areas should take note of these successes, and should aim to be broadly consistent both with the National Development Strategy, and with the treatment of investment in sectors with different priorities and problems.

Let us now consider some of the options that face the government, assuming that foreign investment is welcome. A first (and important) option facing the government is simply to do nothing - nothing that is, beyond continuing the sound management of the economy and concentrating public expenditure in areas deemed to be of high national priority. If this were the option chosen, then investors would be free to identify projects and invest in them subject only to their being satisfied that the laws of Papua New Guinea were not in any way to be violated. In this approach, then, the government merely sets the scene in any modest way, against which the private sector takes its own decision. A second available option, and perhaps the one at the opposite end of the scale from the first, would involve the government in vigorous promotion of national participation in manufacturing and service industries. There would be a number of approaches to this objective, including the taking of government shares in industrial enterprises, the establishment of state development corporations which might or might not hand over businesses to national entrepreneurs when these businesses were established; they would also include prevention of foreign participation in certain areas of business reserved for nationals, and the use of fiscal incentives and protective measures to promote nationally-owned business activities where appropriate.

There are those who would suggest that government policy in the last few years has involved a combination of these two options.

Then there is a further series of options deriving from the view that industrial development should have some specific purpose in mind, be it import substitution, export promotion, employment creation, increase in the local value-added component or whatever. This type of approach is often very appealing - but in my view this type of thinking is largely responsible for some of the calamitous industrialisation experiences of Third World countries.

Take, for example, the possible development of a vigorous programme of import substitution. This would necessitate the conscious adoption of a policy of subsidising foreign and domestic investment. This could be done through establishment subsidies, or through operating subsidies, or through a permanent rise in the tariff wall, or through the use of selective import controls to permit the establishment of secure markets for domestic goods, though almost certainly resulting in price inflation. There are those who suggest that Papua New Guinea's long run interests lie in this direction, taking into account our present dependence upon Australian aid, and upon earnings from commodities sold in volatile world markets. Thus it is sometimes argued that our exchange rate reflects these conditions, and not the requirements of industrial development; if import substitution were to take place then these various subsidies would be necessary to compensate for the exchange rate position.

But then an equally forceful case can be made for the alternative strategy of export promotion.It is often said that Papua New Guinea's wage levels and other features of our cost structure, are such as to make us non-competitive with the low-wage and low-cost economies of South East Asia. This neglects a number of significant advantages which Papua New Guinea is sometimes said to have. These advantages include considerable potential for future productivity increase, recent productivity increase has been substantial in view of the rise in output without a compensating rise in employment (stagnation of employment growth has probably been largely due to recent wage increases). Secondly Papua New Guinea has preferential access, denied to other South-East Asian countries, to the Australian market; Australia's own internal wage costs, for example, greatly exceed those of Papua New Guinea. Thirdly, Papua New Guinea also now has preferential access to the European market through membership of the Lome Convention, at present very little can be made of this, and it should be borne in mind that we compete with nearly 50 other developing countries in Africa, the Caribbean and the Pacific, we do not however compete with other Asian countries in this market. Perhaps therefore, vigorous export promotion could begin, with incentives where necessary, but without the necessity for protection in the domestic market, and based upon our rich and abundant natural resources - basing industries upon hydro-electricity, upon timber, upon fisheries and food production.

Arguments of this kind can be drawn for almost any "objective". I would like to suggest that it is a somewhat futile exercise. In economic terms, each base is simply an argument, that the market price of a particular input or output is not a proper reflection of its true economic value. Thus a “shadow price”, it is argued, should be used to value foreign exchange, skilled labour, unskilled labour, or capital.In many cases this approach will be quite correct, but, cast in these terms, the problem emerges as one of combining the best possible alternatives - not as one of promoting a single industrialisation objective. How, then, do we choose the right combination?

As is well known a number of national objectives conflict with each other if taken simultaneously. For example the objective of fiscal self-reliance, may not immediately be consistent either with the increase in the proportion of the economy under the control of Papua New Guineans, or with the aim of a more self-reliant economy in terms of goods and services supplied through local production. Similarly, the objective of raising income-earning opportunities and the standard of services in the rural areas may not, in the short run, promote the maximum contribution to Government revenue. This being so, it is likely that no single strategy of the kind we have outlined above will satisfy all objectives in the short run, or even in the long run. This means that we have to exercise caution over proposals for industrialisation which seem to be simply justified in terms of import substitution, or export promotion, or employment generation.

The Government has to develop a consistent approach to the evaluation of investment proposals which takes into account all these considerations, and the National Development Strategy.

The government has to develop a consistent approach to the evaluation of investment proposals which takes into account all these considerations, and the National Development Strategy.

This consistent approach would require two sides. Firstly, it requires consistent methods of the evaluation within government which can be applied across the whole range of activities with public. revenue and expenditure implications. Secondly, it requires a consistency of policy towards the investor or business man.

In evaluating new investment proposals it has to be borne in mind that all types of assistance, incentives or protection offered to a new foreign investment have costs which can be expressed in terms of opportunities foregone for alternative development activities. There is thus a strong case for incorporating into investment evaluation the same criteria as the government is now attempting to apply to new public expenditure proposals as a whole. This is a point which has often been made, but of which very little notice has usually been taken. For some reason there is a prejudice against considering, for example, a proposal for public expenditure on an improved agricultural extension programme, in the say way has a proposal for raising the level of the protection for, for example, a factory to fabricate steel products. In both cases, the economic environment in which the projects are brought forward is the same, thus there is no reason why the same valuation should not be attached to foreign exchange flows in the cost-benefit analysis, to the flows of public revenue, to the valuation of labour and to other elements entering into the economic calculation. In future years this is an area of policy co-ordination to which the government will have to turn its attention with increasing vigour. only if we do this we will be able to make sense of calls for import substitution, or export promotion, or claims as to the particular benefits of particular industries.

Turning to the other side of the coin, we have to examine the requirements for consistent policy towards foreign investors. Here we can take a leaf from the book of government policy towards extractive industries. A realistic approach to this problem will require at least the following elements.

Firstly, policy must be firm, tested and durable; this requirement can, of course, only be met over time, but a start has to be made somewhere, as it was made in renegotiation of the Bougainville Copper agreement in the case of extractive industries.

Secondly, if we are to welcome foreign investment we must recognise the requirement of the investor for a fair return on capital he has invested, in the light of current international and domestic market conditions. Thirdly, once the requirement of the investor for a fair return is granted, then we can consider the priorities and requirements of government. The

Government can ask, through company taxation and other measures, for a reasonable share of what might be called the national “rent”. This is the return that should accrue to the nation from the establishment of a successful industry in Papua New Guinea, it represents a return to the opportunities provided here, for government promotion activities, for sound economic management and so forth.

Fourthly, government policy towards manufacturing and service investments cannot rely on a single device, there must be flexibility in the financial package, and if incentives or protection are judged to be required and justified in a particular case, then a variety of methods must be available to the government. In this regard, it would seem sensible to argue that a capital subsidy might be appropriate in one case, that a tariff might be more appropriate in another and so forth. Fifthly and finally, any policy that is to be nationally acceptable must make absolutely clear the right of government to insist on a contribution from investors and businessmen to those priority areas of national development which do not have readily assessable financial implications. These include localisation and training programmes, the development of Papua New Guinean business expertise in particular sectors and activities, environmental concerns, and industrial relations. It is in these areas, as much as in tax and profit questions, that sound relations between the host country and foreign investor must be built.

It is correct that in exchange for the opportunity to operate profitably in this country, the government should be able to say to a foreign businessman that, to take banking for example, a certain proportion of loans should be made to nationals for business investment purposes. Or that a certain training programme should be provided to ensure a particular rate of localisation consistent with efficiency. In the retail trade, it is right to suggest that large trading companies should offer the benefit of their experience and expertise to small Papua New Guinean businessmen wherever possible.In these ways the unfortunate consequences of the kind of developments that have taken place in some other developing countries for essentially nationalistic reasons would be avoided. There is a future for foreign investment in this country, wherever it is perceived to contribute to national objectives; and treatment of it should be such as to maximise the long-run benefits to Papua New Guineans.

PHILIP DANIEL

ADDRESS BY MR R J BURGE

GENERAL MANAGER (MINERALS DIVISION) THE BROKEN HILL PROPRIETARY CO LTD

to the

INSTITUTE OF NATIONAL AFFAIRS PORT MORESBY

"A REVIEW OF THE PROBLEMS CONFRONTING A LARGE EXTRACTIVE INVESTOR WHO IS CONTEMPLATING A MAJOR PROJECT IN PAPUA NEW GUINEA"

3 AUGUST 1977

First of all, may I say how honoured my company and I are to have been invited to address the Institute among such distinguished fellow speakers.

These are interesting and exciting times both for Papua New Guinea and BHP and through our Ok Tedi Project both your country and our company can hopefully look forward to a rewarding developmental partnership.

I was asked to give, and I quote: "A brief outline of the problems confronting a large extractive investor who is contemplating a major project in Papua New Guinea."

Obviously that is quite a task; especially in 20 or so minutes.

What I would like to do is talk in some general way about the problems as I see them, and specifically about the experience we have had so far with getting the Ok Tedi Copper Prospect Feasibility Study off the ground.

With uncertain political and economic times facing many countries throughout the world, the decision-making process for companies considering investment in a foreign country is made even more difficult.

As we all know, many major international companies when investing away from home have had their fingers burnt through changes of government policy, and changes of government itself. Because of these experiences, companies are looking very critically at foreign investment, especially in developing countries. Conversely, companies also do not have an unblemished record in their dealings with host governments and understandably, governments are looking closely at companies wishing to invest in their countries.

With that said, I would like to record here and now that we have been able to achieve with the Papua New Guinea government, a most satisfactory agreement for the Ok Tedi Project and I believe they feel equally satisfied. We think, so far as Ok Tedi is concerned, that we have arrived at a desirable compromise between Government and the investor.

The Papua New Guinea Government has for its part appreciated that if the country is going to develop, the impetus for this is going to be assisted by foreign investment in major resource projects. By this I do not mean just mining. Other areas such as timber, agriculture, and fishing are going to be increasingly important.

For the country to develop along these lines; I understand the Government has realised that it will have to allow investors to come in on terms which are attractive. In Ok Tedi's case, the Government said it would like, in the event of a development, to come in as a partner and that it was willing to pay its own way up to 20 per cent. This is a refreshing attitude. Many host governments around the world ask for, and sometimes receive, a free carried interest in projects as the price for granting the concession to the foreign investor. Increasingly, that kind of government thinking is inhibiting potential investors. We feel that with a 20 per cent interest in an Ok Tedi development, the PNG Government can not only have a demonstrable equity in the project, but be a constructive and valued voice in its operation. This equity will allow the Government to keep the project under surveillance and contribute more than simple bureaucratic control over its destiny.

The government has been fair and flexible but not generous in the taxation regime they have proposed for Ok Tedi. They have recognised that one of the problems for the consortium is going to be in the raising and servicing of the very large finance which will be required in a development. Part of the problem will stem from the fact that the Papua New Guinea economy is largely untried as far as major international finance houses are concerned.

One way of improving the security from a lender's viewpoint is for the government to help the project's early cash flow through taxation policy. To their credit, the Government has realised this and in our case are willing to postpone taxation benefits in the early years of the operation and collect their greatest taxation rewards after the project's capital has been recovered and the investors have made a reasonable return.

These concessions apply not only to additional profits tax but to normal corporate taxation as well.

In lean cash flow years before capital "payback" is achieved, the Government has agreed to provisions concerning accelerated depreciation which will redistribute some of the tax liability to later years. This also applies to additional profits tax in that while the project will have to pay this tax, it will only be liable for it if the minimum rate of return has actually been achieved.

This rate of return has been set at 20 per cent and this is probably just high enough to convince an investor that a reasonable return will be allowed before additional profits tax is levied.

What is significant about this policy is the flexibility that was shown by the Papua New Guinea negotiating people. I must admit that we could have expected that they would have sought the Bougainville Copper - type system for additional profits tax which may have traps in it for the investor. This is particularly so when you have good years when the tax applies, with no allowance for bad years, before or after that, which are not taken into account in striking a normal return for the project for the calculation of supertax. The Ok Tedi additional profits tax system eliminates this danger.

Compared with other countries, particularly developing countries, the taxation provisions we have agreed with the Papua New Guinea Government are probably as attractive from an investors' viewpoint as have been reached elsewhere in the world. The royalty provisions are very fair to both sides and apart from the 20 per cent ownership, which, as I have said, is paid for by the Government, there is no provision for compulsory acquisition in the project or for carried interest.

Another question of vital concern to a potential investor is whether or not he is going to be able to take his money out of the country, either in the form of profit or capital gain, or whatever. I think it is now almost universally accepted that the host country must be able to exercise pretty firm controls over its foreign exchange reserves and foreign currency transactions. This for no other reason than that it must protect its reserves and the value of its currrency. The Australian Government and many others have exactly the same policies. That being the case, it would be unrealistic for a foreign investor in a developing country like Papua New Guinea to expect that they would have complete freedom to transfer foreign exchange in and out of the host country. In the case of an Ok Tedi development, they would be quite large sums by Australian, let alone Papua New Guinean standards.

While there are provisions in the concession agreement for the Ok Tedi project to be subject to the normal Papua New Guinea exchange restrictions, there are comfort clauses which indicate that under normal circumstances it would be reasonable for the consortium members to expect that they would be able to take their money out of the country. Not only are there these clauses, but there is also a machinery clause which allows a certain proportion of the proceeds to be kept offshore to meet regular overseas foreign exchange commitments, including the payment of interest, capital and loan repayments and dividends. If the Ok Tedi project is to succeed, it obviously needs the continuing goodwill of the government, at both the political and bureaucratic levels. So far we have had nothing but the greatest cooperation and goodwill at the political level and this is true of most of the government departments. We recognise that it is in the project's best interests to make sure that the government is kept fully informed as to hwat is happening. After all, we are partners-to-be in the project if it is finally developed.

What I can say on this question is that in the case of Papua New Guinea we have gone further than we ever have with a host government in terms of operational openess and candor and further than we are required to go under the terms of our concession agreement. We have done this for a couple of reasons. First, we do not want the project to suffer from delays and secondly, we do not want any governmental or bureaucratic suspicion that we are doing anything clandestine. I must say how pleased we are that the government has established a project management committee. We are sure this will mean closer and more efficient coordination between the consortium and the Government. For our part, we are allowing government observers to come to our participant's management committee meetings and we are happy for them to contribute to the discussions. It is like inviting someone to a company board meeting who is not a director and who does not have any formal right to participate.

The environment, with all its factual and emotive implications is a vital part of the Ok Tedi study. We will undertake an environmental impact study which must be submitted to the government along with the project feasibility study which is due in May, 1979.

The environmental impact study will be carried out by an independent group so the findings are not open to question or suspicion. And there are other conditions placed on the scope of the study. There is a limit in the extent to which the environmental protection controls must be followed by the project. The controls must be technically and economically rational. This sort of recognition is of great importance to the future of projects like Ok Tedi and the Papua New Guinea economy itself. But there are real environmental issues surrounding Ok Tedi and I can assure you that we will be sensitive to them. For instance, the Fly River system could suffer from silting or other damage from escaping tailings or mine wastes. There are international implications too. The Fly River flows through Indonesian territory. But we are doing our best to understand these potential problems and our responsibilities. What is needed will be a balanced view of the environmental impact of the project and we are confident that will be forthcoming.

Another possible problem which was somewhat demonstrated at the recent Papua New Guinea election is the stability of Governments and the politicians who form them. I must say we were disappointed to see two or three of the Ministers we had come to know and work with lose their seats but we look forward to meeting and working with their successors.

A further thing of concern both to a company contemplating a venture and the host government is the allocation of resources - especially human resources. In the event of an Ok Tedi development, the requirement for skilled and semi-skilled nationals is goind to be considerable, especially during the construction phase. And obviously, Papua New Guinea has other developmental projects such as roads, bridges and buildings, each with their own demands for people.

Should another major natural resource scheme, such as Frieda River, get off the ground at about the same time as Ok Tedi, the competition for skilled and semi-skilled people could be to the detriment of both projects and strain local resources beyond the limit. In projects such as Ok Tedi, it is of course not just the project itself which needs people, it is the infrastructure which is required to support it. This infrastructure also would be competing for labour.

Competing projects and infrastructure developments can also strain the bureaucracy and problems can arise from public servants trying to coordinate and assist too many major projects at once. If this manpower problem can be quickly overcome, it will diminish in significance as projects develop. They will train more and more people and as time goes on, will become self-perpetuating in people terms, even to the point where a project like Ok Tedi would become a net provider of skilled people for other developments. As well as learning skills on such a project, nationals will learn much of value about the general concept of an industrial society. Already the Ok Tedi feasibility study is employing more than 200 people. About three quarters of these are Papua New Guinea nationals. We made every effort to train local labour and many of them are now working successfully on drilling rigs and mining equipment and others are working on tunnelling operations, in the sample laboratory, drill core shed, assay laboratory and driving earth-moving equipment. This raising of knowledge and experience will be most important to Papua New Guinea in the years ahead. There is no doubt that future projects will be made progressively easy, just as our project will have been made easier by the Bougainville experience. They made a very significant contribution to the level of technical skill in the country.

What I would like to do at this point is briefly outline our work so far on the Ok Tedi Feasibility study and tell you something of what is planned. The study is costing about (Rust.) $10 million and much of this money is going into the Papua New Guinea economy. Wages, food, aircraft and survey vessel charters, fuel and a hundred other cost items are all being purchased here in your country. There are other benefits too, for Papua New Guinea. The Ok Tedi venture is receiving wide publicity in Australia and throughout the world and this will help add to Papua New Guinea’s growing international standing as an active developing nation.

Now to the study itself. Phase one of the drilling programme began in mid November 1976 and was completed in January this year. During this work our three rigs completed three thousand, eight hundred and thirtyone metres of drilling. Phase two was even more ambitious.It involved the drilling of eleven and a half thousand metres.

Phase three has started and includes a further five thousand metres of drilling by the end of the year to complete this programme which is designed to test the currently-known ore-bodies. Results of the first two drilling programmes are now being assessed to determine ore reserves that could be mined by open pit methods. As part of the metallurgical study, two adits, or tunnels, will be driven into the mountainside.

The first, which has already advanced more than ninety metres into Mount Fubilan, is designed to test the gold bearing capping overlying the main copper orebody. This adit will be driven two hundred and forty metres and the tunnelled material will be processed through the bulk sampling plant we have installed on the mountainside near the portal. Establishing the sampling plant was quite an operation in its own right.It had to be carried piece by piece onto Mount Fubilan by helicopter and assembled on site. Later, when it has finished work on number one adit, the plant will be pulled down and carried by helicopter to the site of number two adit on the other side of the mountain. There it will be reassumbled and used to sample the copper ore from that tunnelling.

In both adits, each tunnelling advance will be sampled and results of each assay compared with those of the vertical drill holes. In addition, in the case of number one adit, a bulk sample of thirty tonnes of gold bearing ore will be taken and shipped to Australia for pilot plant testing. The second adit, to be driven five hundred and forty metres through the copper orebody, will also be processed through the sampling plant and compared with drilled samples.

In the case of number two adit, we plan to take three hundred tonnes back to Australia for pilot plant metallurgical testing at the Australian Mineral Development Laboratories in Adeliade. As well as drilling and metallurgical test programmes, engineering studies are also under way, particularly in the vital field of transportation.

Most of you will appreciate just how rugged this remote area is. We have completed preliminary surveys of the Fly River from its mouth to Kiunga. We have also looked at possible ocean port sites near the mouth of the Fly. We have also assessed other ways of how we might transport the copper and gold from Ok Tedi to the coast. These include a slurry pipeline system and road transportation either from the minesite to Kiunga or from the minesite to the Highlands Highway. Township, port, and plant sites all must be considered.

The Papua New Guinea Government is studying possible hydro-electric schemes as part of their work on the infrastructure. A start has been made on the environmental impact study and we are reviewing the already gathered information available within Papua New Guinea Government departments. Our engineers are considering various mining concepts, including the removal and dumping of waste material. As you can see, there is a lot of work to be done before we present our completed feasibility to your Government.

Most of what I have discussed today is of of tangible nature but there are more intangible elements in the relationship between a foreign investor and a host country and its people. There are cultural and language differences and just the general business of getting to know each other. Fortunately, the commercial systems and customs applying here are very similar to those we know in Australia and we do not have to cope with the added complication of relearning that part of doing business.

The subject of working together with people of another culture was referred to by Mr Somare in 1975.

We hope that an increasing understanding and awareness of your culture will enable the minimum disturbance in the geographical location, which as you know, has had little contact with western civilisation. We see this as a fascinating and rewarding part of a development and are looking forward to developing mutual understanding and respect as much as we are looking forward to developing a mine.

INSTITUTE OF NATIONAL AFFAIRS SEMINAR, 3 AUGUST 1977

AGENDA ITEM 1

Opening address and welcome – Mr McClellan

AGENDA ITEM 2

A general outline of the Government's economic policies with specific reference to foreign investors – Mr Julius Chan.

Mr BENDALL – Mr Chan, have you any reason to believe that a change in Government – should there be one – would of necessity lead to a change in attitude to foreign investment and to the work that has been done in the last five years with the establishment of NIDA, or the set of priority schedules and broad guidelines that have been set for foreign investment.

Mr CHAN – I do not have any reason to believe that, but you know I will be telling a lie if I pretend everything is going to be the same because policies of the Government depend entirely on the makeup of the Government and individuals have different views. I think what I have tried to say is that the main foundation of this area of policy which has been set will take time to change. There is no reason for me to dispute there is going to be any change but that depends entirely on the makeup of the new Government.

Prof. CLELAND – Seeing as NIDA is not here to talk, I know you have been immediately concerned with NIDA – what has been the main problem in the way of NIDA's smooth function and how would you hope that this could be improved over the next few years?

Mr CHAN – To begin with, I am not familiar really with the bureaucratic establishment of NIDA, and I do not want to say anything that might be in conflict with my colleague, but I can say something that I am familiar with; the establishment of NIDA was mine. I started it off in 1973. I started to think about an authority which might later on help to screen and streamline some of the proposals, so I thought to establish an authority like this. I did not envisage NIDA was going to develop to such strength but

Mr CHAN (continuing) - it did. Towards the end of 1973 or early 1974 there was a reshuffle in Cabinet and NIDA went from my control to another Minister. It took me about 9 months to think about the establishment of NIDA but it took 6 months to get the legislation through. That is where I lost control of NIDA. I have heard of many complaints from the private sector - some perhaps legitimate - but I must be frank and tell you I do not really know the inside problems experienced by the private sector. I believe in following the path of reasonableness and that in anything you do try to do it slowly so that you build in confidence all the time. This is in practically every case or every insttution we establish - stage by stage, so long as we reach our goal in a reasonable time, I think it is a great achievement.

I do not know what NIDA has done in the past three years but I usually welcome a swapping of problems - problems you have encountered over the last few years - so that the new Government when it comes into office looks critically. I have to be fair, so far as I am concerned in my experience, I have not experienced a very vibrant private sector, and at times I do not know who is speaking the truth. I think I am very much encouraged by the President’s address this morning outlining the aims of this Institution, that you will become a constructive force in future and contribute towards various government policies in years to come. It is very essential.

I have never seen a gathering of private sector with so many people attending in the past five years. I have always tried to talk to the private sector - I have established the Economic Affairs Council. I am encouraged today to see for the first time the private sector representing all industries together - I think this should continue.

Mr THURECHT - We listened quite readily to the comments you made particularly about the role of private enterprise. I would suggest that private enterprise accepts some of your criticisms, the others it rejects out of hand. Possibly some of these criticisms are given without a full knowledge of just what the private enterprise is

Mr THURECHT (continuing) - doing and that becomes a public relations problem rather than lack of effort or knowledge by the private sector on what is going on, and the fact that some efforts of private enterprise to liaise with Government have not been quite as successful as you would have given us to believe.

One of the points you mentioned was labour relations. You briefly mentioned the fact that private enterprise is screaming about localisation. I think we should make it clear private enterprise is not against localisation, but is is firmly against forced localisation. You know the old adage: You can lead a horse to water but you cannot make him drink.

I think it would be far better if the Government formed a liaison group on when full localisation should take place where the private sector is working with government not against it.

The other point you make I find surprising - that when the Government first took office it stated it would not support labour intensive industries. I noticed during your speech you reiterated this. I think we know the meaning behind it. I think you really meant you just do not want the national people to be utilised for overseas enterprise's benefit but we have to give and take in life and I think you are the first to agree. Can you explain if you are not going to support labour intensive industries, what you are going to replace this with? The Government has an intensive education programme taking place and as people become educated they are less inclined to stick with the traditional way of living out in the village. There is, because of education, a very big drift to urban areas. I think that you would find it very difficult to stop this - you can retard it but not stop it. It would seem to us you need some industries that are labour intensive.

Mr CHAN - I do not want to face you in Parliament on the opposite side because you seem to have misinterpreted all my points. I hope not for your aims. I did not say first of all that the Government did not welcome labour intensive industries - far from it. I said part of the reason for any investment at all should not be confined to any one area of achievement, whether it is labour employment or something else - it is a total component. It must be labour

Mr CHAN (continuing) - training, it must include revenue - generating all these things together it makes a reasonable climate for investment. That is what I said - not as Minister for Finance. I am not altogether a labour intensive man. I am looking forward to the future with a country the size of Papua New Guinea with such land mass, three million people, if we are starting to grow very big in labour intensive industry we will draw down every man, woman and child in this country to get a job. I am inclined to be more capital intensive, but that is my personal view, it does not belong to anybody.

Papua New Guinea is an agriculturally based economy and if we have the Government's aims of trying to decentralise, it is important we must confine these industries from creation so they do not become too labour intensive and try to help people in the rural areas. I see a day not far from now when we have too much labour intensive industry and we are likely to draw on the resources of this country leaving the agricultural sector bare. That is my personal opinion.

In terms of localisation I note you have a complaint.

What I am saying it is not good enough to sit back in a comfortable chair in an air conditioned office, wearing horn rimmed glasses and expect everything else to happen - it will not. Things will not happen by chance, it has to happen by constructive analysis of the situation, drawing up your resources, identify your problem and objections to the country. Perhaps you might be able to speed up the localisation process much faster.I know the private sector is experiencing problems because of what they call "forced localisation problem". I do not think in terms of that. It has been going on since Government took office five years ago. We are starting to set a target for localisation, but not forced. You do not want to kill the goose that laid the egg. Private sector is contributing a lot to the revenue of the country and if you stifle that it is conflicting to the overall Government policies of localisation and trying to get more revenue. I think the private sector ought to look into the machinery of business - I do not know anything about it as you put, but I think if we critically examine the sort of

Mr CHAN (continuing) - situation you are in, try to identify the sort of structure you have and find out if the sort of bureaucracy you have been blaming the Government about are the same - simplify them and make them suit the situation of Papua New Guinea principles and those areas of localisation can be speeded up without too much problem. Anything new is going to be hard but over a period of time I am not sure because I am not advertising our trade, industry has a particular problem and I do not want to put my neck on that, but there is a thing for us, so let us not talk about the past. A new Government is coming, localisation is needed, jobs are needed for local people - several hundred thousand may be out of jobs in five years time - you have to do it and you have got to do it in conjunction with your analysis of your profitability and etc, etc.I am putting all this as a hypothetical answer, there is no specifics, it is only discussion.

In terms of liaison I can only speak for myself. I have been available at all times to meet anyone, except when they want to ask me about tax reduction, but I have been available all the time in the last five years, meeting various people and I think to be fair the Government Ministers of Papua New Guinea have been more than open. I doubt it very much if you will find a similar situation anywhere in the world. You have to have 10 months appointments in Japan, but we do not want to be like Japan. We are two different countries. We want to be Papua New Guinea. There is an open door policy in Papua New Guinea with Ministers, heads of departments, banks, they are all available. This is only one area of communication, but in the other areas I think the Government has tried very hard to make its officers available to talk to the private sector. Finance people are here, economic control people, investment people and they should be here. They are supposed to work with us, but it is not up to them to generate liaison. Once we establish it I think the Minister for National Development has asked for a forum and we can only try, we cannot force the private sector to come, but with good intention I hope the future will be better.

Mr KIRKE - Assuming that the new Government will very closely be similar to the old Government what are the chances, if any, of ministerial responsibility for trade, commerce and industry being divorced from labour?

Mr CHAN - I think the chance is quite good. I am always confronted with this type of question. If anything I think it is economically sound. I think that the chance is reasonably good.

Mr HARVEY - Just to add to that, what are the chances of having a nontrade unionist in the portfolio of labour?

Mr CHAN - Just like saying you should not have a businessman running an institute, something like that. It is not for me to say. Appointment of ministers is the prerogative of the Prime Minister but I think in my experience which is very little, but in my experience I think people adjust themselves to the situation when they have to take responsibility.I do not know how much adjustment has taken place in the last five years, but I think I am confident that whoever is going to handle that portfolio, I think he is going to serve it with the integrity that the community expects of him.

Prof. CLELAND - I have been in the position of sitting on the Economic Affairs Committee for several years and I must say that what he has said in relation to the openess of his office is completely true. In the ideas that have been put forward he has given complete encouragement every time. He even allowed me to come down at one time and thrash out a certain bug that I had in my mind with him and his officers. He has been so open and so positive and frank and I believe a man of complete integrity and I believe I speak for all of us when I wish him every success in the forthcoming government and I hope he remains in his present portfolio.

AGENDA ITEM 3

Problems confronted by investors who operate in the manufacturing and service sectors - Mr R Elias.

Mr BURGE - I would like to ask a question as a visitor. You said in your address, why increase wages when you have unemployment. We have a big problem of unemployment in Australia and a lot of it is caused by the increasing of wages all the time. This is a very big problem in Australia.

Mr ELIAS - I see the problem in this country as a fairly recent development and it is unfortunate that I have to make these comments when the Minister is not available. I wish officers from the department were available to add to the comments I make. I find in the last four years the rate of unemployment is encouraged by a number of things. The educational output of students, both primary and tertiary has been intensified and the students who have left schools and tertiary institutions would normally look for jobs in urban areas. In other words the unemployment which is experienced in this country, it is not a national problem, it is an urban problem. Increased wages are a problem.

Mr JACOBSEN - I am not from a Government department but I would like to ask a question. Earlier in the paper you mentioned that the Government considered it necessary for a local manufacturer in Papua New Guinea to produce a product cheaper than the imported goods. I would like to ask why if there were not substantial numbers of people employed or if there was not substantial numbers of ingredients in the article being manufactured that we can produce in Papua New Guinea, why should the Government support any manufacturing concern that could not produce its product cheaper to the consumer in Papua New Guinea.

It was also mentioned in your speech regarding the implied unfair advantage that foreign companies have over the local manufacturers. It is unfortunate one of the examples you gave was the possibility of some subsidiary companies being able to import flour at 30 per cent cheaper than competitors. I would point out that flour and wheat sold out of Australia is governed by the Wheat Board and this leaves a very small margin for manufacturers of flour to make any advantages in price - if they do so this naturally has to come off their own profit margin after buying from the Wheat Board.

Mr HELAI - Perhaps I am confused, but Mr Elias has made reference to Papua New Guinea having low production power here as to market. I cannot relate that one with the lowering of wages and so forth. How does this relate if the purchasing power is low, and then we put the wages down - does that increase the purchasing power?

Mr ELIAS - Taking wages as the only component in cost production - this would lead to a reduction in purchasing power. By reducing the cost of labour one tends to employ more people - if you employ 10 people, instead you would employ 50. This is an increase in the number of employees. The sum total of what the wage earner receives may not be much more but the cost of production and prices hopefully is lowered.

Mr GROENE VELD - To what extent should a local manufacturer receive some form of protection from imports of similar products made by the local manufacturer but of marginal cost to the exporting country as a result of export incentives or differential costs of raw materials and indeed exported at prices below those normal prices applicable to the same province in the country of export?

Mr ELIAS - Could you break that question up?

Mr GROENE VELD - Many countries institute export incentives to take care of surplus production capacities that are available in the exporting countries and thereby unfairly compete with the local manufacturer, in Papua New Guinea for instance - by being able to undercut them in their price structure. My question is - to what extent should the local manufacturer receive protection against this - what I consider - unfair competition?

Mr ELIAS - There are two ways of looking at it. I think the Government would agree that the consumer is the one to be considered as the primary objective but to the investor, the return on investment is more important.I speak on behalf of the investor in the sector but at the same time the investors are also consumers. Looking at it from the consumer point of view, if the consumer can obtain the particular goods which are produced here locally at cheaper prices (but not unfair prices - through devious means) - I have nothing against that but if the intention of the exporter of the goods is to bring them into the country at potentially low prices it will make it difficult for the local investor to get a good return - then I believe the protection is a quantitative restriction. I do not like those things but there should be a short term means of

Mr ELIAS (continuing) – assisting a particular industry and this would be applicable for two years. Depending on the current machinery installed, two years would be sufficient to let the particular firm benefit from the protection. He could then get his rightful share of the market.

TEA BREAK

AGENDA ITEM 4

A Synopsis of Present Government thinking in relation to Investment policy for extractive industries problems and prospects – Mr N Agonia

Mr BENDALL – I am not quite sure on something – you referred to using the New York Bond Rate as an inflationary measure – can you explain a little further exactly how that will work?

Mr AGONIA – This particular area is outside my department. I see a few Department of Finance representatives here – Mr Palmer and Mr Woodward.

Mr WOODWARD – Firstly, I am not really an expert of this field, but I think I do understand the basic reason to include some reference to the Bond Rate in the deal that we concluded with a resource investor. The theory behind it really is good and it has been reinforced by recent experiences of interest rates which have fluctuated a great deal. What is a reasonable return on investment now would not have been a reasonable return say in the 70's – early 1970's. Interest rates are influenced by peoples expectations of the rate of inflation and by the relative scarcity of the demand for capital. What the Government has attempted to do for instance in the Ok Tedi agreement is to allow for any changes in the expectations of earnings or the return of earnings an investor requires between the time that the commitment is made to go ahead, what the expense is of gaining the resources, what time that the finance has to be negotiated, what equity partners put up, their contribution for the project, so that what we have is a means of indexing the rate of return which will amount for any changes in the general expectation of inflation between the time of the initial commitment and the time that the details of the project are finalised.

Mr BURGE - This will be pre-empting a talk I am going to give this afternoon. I was hoping that question of Ok Tedi would be cleaned up this morning. I think you will find in retrospect at the end of todays session that the talk by Mr Chan this morning and the one that has been given and mine, have a lot in common because I intend speaking about the financial aspects of the Ok Tedi agreement in terms of the 20 per cent return and the terms of the currency we can take out of the country and the great cooperation and flexibility we have had from the Government of Papua New Guinea in terms of the agreement we now have with that Government.

Prof CLELAND - Do you see some confusion arising in the sense that natural resources is mainly dealing with the mining area, whereas you may have a large oil palm scheme which will come within the area of primary industry and you have similar investment project aspects - are you getting together on these things? Is this white paper going to deal with this?

Mr AGONIA - I am in the position where I have blinkers on, but the Finance Department has a section which deals with this in coordination with other natural resources departments. I tend to see similarities between mining and petroleum as related to forestry, fisheries and oil palm. Maybe the representative from NIDA or forestry can answer that particular question that is an overview of our policies of mining and other policies. Mr Palmer may be able to comment on that. If Mr Saville from Primary Industry could also make a comment.

Mr PALMER - Just a brief comment - I think it is true to say that we would see principles that have been applied to mining and petroleum as being applicable because a range of natural resources - particularly timber and fishing come to mind - by the same principles. I mean the concept that some part of the return from the natural resource is due to that resource and should go back to the owner of it, but the investors should en ensured a reasonable return. Beyond that we have found particular difficulties in any formula applied to cross sectors. One thing most businessmen will agree on is that the problems are different in industries, because in the timber industry it is difficult to apply a profit tax formula we have in

Mr PALMER (continuing) - mining, for reasons I am not going into now. In the fishing industry we are still evolving a policy there and the most one can say is the principles are the same, the specific formulas for getting out of the red will have to be different because the problems are different.

Mr AGONIA - In this paper it was stated that even though the country has gone through a period of post-elections, outsiders and investors are still interested in investing in this country - that is true. We have people continually looking at prospecting for minerals and petroleum in this country. I tend to feel that there is faith in this Government and its policies especially in relation to large-scale investment. People are still prepared to spend money even though the world economic situation has declined. The reason is that there is something in black and white, something stated on paper and they feel that they can trust these policies and even to the extent that they can trust a country during the time of elections by continuing to come and explore knowing that there is no guarantee that when a new government comes in to being the policies won't change. It is good to see that people, especially in mining and petroleum are willing to come in and spend money in exploration.

Mr MILLET - The level of cash flow returns, is that constant in all developments or would it vary taking into account the specific characteristics of that development, say Bougainville Copper we know - Ok Tedi we are looking at?

Dr PALMER - The intention is that there should be a fixed margin above international interest rates.

Mr WOODWARD - Mr Chairman, this is not a question for the speaker but I wonder if the business decision makers would care to comment on the assessment of the level of returns that have been built into the mining agreements.

Prof CLELAND - I would like to support that, perhaps because I am a professor of accountancy, but I would like to know how they work out the risk aspect in some concrete way.

Dr PALMER - Actually this question does relate to the one that Mr Millet asked. You look at a particular mining venture, let us take Ok

Dr PALMER (continuing) - Tedi and the way that we determine what is a reasonable return in that situation, could I think, be described as a pure bargaining situation. When the Government found it had the deposit we went and offered the project to a mining company, talked through the difficulties and then talked about numbers and then talked about the numbers that came out most consistently and then looked for the lowest one and in a way, that is the appropriate way of going about it, I think.

The risk is not something you can measure in an absolute way, it is something the mining companies test. It was very surprising to me perhaps to find the extraordinary range of numbers that we did, in fact, find. Having discovered a number that was for Ok Tedi, which was the lowest we could go, we then make more or less the general assumption, if you are going to apply across-theboard figure, that the number for Ok Tedi is probably one of the riskiest projects around, so in applying a general across-theboard scheme we take a 10 per cent spending on the interest rates as being more or less the same in Ok Tedi. This means the scheme does not work necessarily as efficiently as it might otherwise do if you negotiated each individual project. If you negotiated a project which was as risky then a lower number than the 10 per cent might be appropriate. So there is a trade-off between getting a higher return to the Government by allowing a reasonably lower return and having general legislation which applies across-theboard and takes the negotiating element out of the business of mining. It is the view of the Government that there is a great merit of having a general scheme of legislation so that miners know when they start exploring what the rules of the game are, so it is a general business and 10 per cent sounds right.

Prof CLELAND - Mr Chairman, the method of calculating the risk involved in these projects as outlined sounds something like the wheeling and dealing we have heard about. I wonder whether this is an appropriate way for a Government to approach things that may become similar to international negotiations and I also wonder whether it provides an adequate reward to the person or the people who first discovered these resources?

Mr AGONIA - There may be a correction on this - but judging from the paper, the extractor once he has returned his initial capital, then he starts getting hit with additional profits tax. I think he is rewarded by the return on investment and anything up to a particular level before being hit with added profit tax. He is able to recoup what he has initially spent and in addition he takes off certain profits after that but anything above a particular level is hit with the added profits tax. I suppose it depends on the industry you are in - in mining, and I suppose petroleum, depending on the price, you get your investment back quicket but in the smaller schemes - primary industry - I think they will be regarded somewhat differently.

Prof CLELAND - My question was in two parts. Firstly, whether the wheeling and dealing method of assessing the risk by offering discovered resources internationally and endeavouring to assess the risk on flows coming back - I wonder whether this is an appropriate method ofassessment for a government to undertake as a matter of policy?

Mr BURGE - You must remember that you are in competition with a lot of other countries. It is not just New Guinea versus the rest of the world. If you take the Ok Tedi operation - there are a number of copper deposits throughout the world which are available and when negotiating with the Papua New Guinea Government you must remember they themselves are taking a risk in first of all letting foreign investment into the country, but they are partaking a risk in equity. In the Ok Tedi operation they will be partners to the tune of 20 per cent so when we do negotiate with the Papua New Guinea Government we must be mindful of not only the Ok Tedi operation but the future, as Nigel mentioned. The Papua New Guinea Government is willing to put up to 25 per cent equity and that is great reassurance to the people who are wheeling and dealing - if it has to be put that way - when they too partake of a risk.

Mr LOVE - You talk of return on capitalisation - are we talking of capitalisation on exploration costs or production? I am thinking in terms of say the Gulf of Papua operations - if one of those companies that has been doing exploration work over these years were successful in finding oil - would they be able to capitalise their costs over the past 20 years?

Mr AGONIA - I think this is taken into consideration in the overall package. I think there is a limit of 20 years - I may be corrected. Mr Palmer, are additional exploration costs included in investments?

Mr PALMER - The return is 20 per cent, in the case of Ok Tedi - on all capital expenditure irrespective of whether it is on exploration expenditure or other expenditure.

Mr HARVEY - Is this 20 percent on total funds or on equity capital only?

Mr PALMER - A tax flow concept of profitability based on total funds investment - so 20 percent of total funds means for every dollar to put in you get a dollar out and earn 20 per cent on the dollar for every year invested.

Could I ask a question? The question that interests us and of immediate concern is whether investors in a number of sectors, not just mining or petroleum, prefer to have general legislation apply across the board or whether they prefer to have negotiated arrangements in each particular industry or a particular project level. The current situation accepted is - in petroleum, timber, fish, and in mining at present is that the Government negotiates each project individually. I would be interested to know how businessmen see the differences between having general legislation which is favoured in all cases as opposed to negotiated settlements which usually delay things.

Mr LOVE - I am involved in advising people on terms of investment in Papua New Guinea - if you have a set policy through legislation or stated Government policy, it is a lot easier to tell people what it is if it is published, but when it comes down to negotiating in a particular area - because you have different provinces and areas, I believe that must be negotiated because otherwise we will have all sorts of problems. It is good to have the original idea of policy or legislation in principle which is stated and guaranteed policy but when you come to the individual investment - fishing, oil palm, oil or minerals - you have to come down to basic negotiations, I believe, speaking on behalf of those in these industries.

Mr BENDALL - I think what Berry Love says is true - speaking as a small time investor. It is useful to have a 'ball park' in which the Government thinks. If it is 10 percent above the ruling rate for

Mr BENDALL (continuing) - mining - we are talking at the moment about 20 per cent, and if that is an acceptable basic return, bearing in mind as Berry says, there are differences between provinces and industries, at least you know and the Government is prepared to accept the 20 per cent return. I venture to suggest that up to date, until this talk and until recent publications, many investors have not had the slightest idea of the sort of return the Government thought to be reasonable.

Mr HARVEY - 1 hope this is applicable in the case of price control.

Mr COOK - I moved out of price control a few months ago, but we have come across this problem. About two years ago Mr Chan made a very veiled statement that he was aware of industries being satisfied by a 15 per cent return, but no indication was given as to whether he thought that is what other industries should be satisfied with. As I say we have been enforcing an unofficial price justification, plus official price justification on items and we have worked on this consensus type of thing, sounding out various businessmen, we have seen what they have thought, we have seen various figures and we have tried to come up with figures for that particular industry at that particular time.

Mr KIRKE - Is it not also at times reasonable to keep down the cost of living so that the Government could have a good image?

Mr COOK - You should have asked that before when Mr Chan was here.

Mr MILLET - Another technical point - if in any year the return is not achieved, can you catch up in ensuing years?

Dr PALMER - The answer is yes, but I would not like to go into why. You can catch up if you get behind.

Mr HARVEY - Is this before or after tax?

Dr PALMER - After tax.

SITTING SUSPENDED FROM 11.40 to 1.30 pm

AGENDA ITEM 5

A personal review of the basic approches necessary to attract foreign investment under terms which are acceptable to all parties, the current position, what needs to be done and what can or could be done - Mr M Bendall

Mr BENDALL - I think it is unfortunate that no representative from NIDA is here today as this seminar was originally conceived by NIDA. After three or four years of the organisation of NIDA, it is sad that they could not take the opportunity to be here, if not actively to participate, to hear the opinions and the questions of a body of people, be they bureaucrats or private individuals, some of whom because of their positions can significantly effect foreign investment, particularly in its early stages. Potential foreign investors, in existing enterprises and to that to some degree I exclude minerals and petroleum, have a habit of talking to the existing companies, to the existing lawyers, to the existing solicitors, to the existing accountants, on what the situation is like in Papua New Guinea from the investment point of view and they particularly tend to talk to the foreign investors who have been there for some time and I think this body here represents people whose opinions are sought by potential foreign investors. For that reason I think it is sad that NIDA is not here today.

(Mr BENDALL continues with his address to the Institute)

Mr BURGE - I would like to reinforce the remarks made by Mike concerning foreign investment in countries developing. He mentioned that the USA was developed on foreign money, Australia had been developed on foreign money and there is no way in these countries that you can possibly generate enough capital for the projects you wish for yourselves, and sometimes, once the country becomes mature, it goes the other way and we are finding now, for instance, in the USA that there are people now being invited to invest in the USA, notably the Arabs and this is also happening in Britain and therefore, I do suggest that you be patient about developing your country, be patient that you have to have money from outside in order to do what you want to do.

On industrial relations it was mentioned that you had long service entitlements and that it was retrospective. I hope you learn from the terrible situation we find ourselves in in Australia with industrial relations, that the people in Papua New Guinea are not attempting to follow the conditions that are enjoyed by the

Mr BURGE (continuing) - people of Australia. There is only one way you can improve conditions and that is you have to produce more to change the entitlements to people. We have the sort of situation now in Australia, where a girl 20 years of age arrived in Melbourne from Mt Newman and she was on long service leave and that is how silly it is in Australia where after 10 years service a person has 13 weeks long service leave, and she was able to take part of it after five years service, due to the fact that the long service entitlements you get after five years service you can take pro rata and if you look at the productivity in Australia, the drop in productivity is something that is really putting us off the map so far as cost of labour is concerned. We have maternity leave now., Some people were talking of paternity leave and the only thing they have not thought about yet is conception leave.

Mr NOU - I would like to express a view of the native of this country in regard to the last speaker's statement. Firstly, regarding a foreigner taking as an example a New Irelander in Port Moresby came to be regarded as a foreigner, but I would like to express the fact that in investment matters the foreigner from one province to another cannot be taken as an international rule just for that sake.

Secondly, that as a member of the NIDA Board, the comments made on NIDAs operation an an industry basis, I feel is not fair because NIDA as far as I am concerned are not operating in isolation and it must seek advice from the other departments and the other organisations due to the fact that the legislation must be taken into account and I think it is only fair that NIDA's operations up to date have been in the best interests of the foreign investment policies in this country.

Mr Chairman, I would like also to supplement this statement of the last speaker but in a slightly different manner, such as hit back at the statements made by the last speaker. Papua New Guinea is a developing country and I attended a meeting in Tokyo relating to foreign investment in relation to Asia and the Pacific and I would like to read to you a view from the other side of the telescope, so to speak, that is, as an investor or a foreigner you speak on one view and we the people of the developing country, we speak a

Mr NOU (continuing) - different way and I would like to be allowed to read to you the problems identified by the developing countries in Asia and Africa.I want to read part of my report which I submitted to the Government after attending a seminar on foreign investment and I will restrict myself to foreign investment policy as a topic of this seminar. The developing countries from Asia and Africa identified the following problems and this is how we view the foreign investment policy.

FOREIGN INVESTMENT POLICY

Foreign investment policy should be viewed within the context of overall investment policy ... reads ...

We feel that foreign investment should be very carefully handled and we feel that there are matters of concern that need to be improved and that is what is correctly stated as the improvement of NIDA on operational activities and that is the administration of the investment policies in regard to consideration of investment coming into this country. I think we are aware that investment from foreign countries is a necessity for development purposes. However we feel that there must be this cooperation between the investor and the receiver - in that this country I think has done its best to satisfy the investors - that should not be forgotten. NIDA’a role can be viewed as in its early stages, and Australia in its early stages has gone through all these problems - and now Australia, or America, or England, are regarded as developed countries. Our problems, although large, have been tackled in a reasonable way.

Mr BENDALL - I am fully aware of the restrictions under which NIDA operate and I think one of the basic points in talking about the role of NIDA was to suggest in fact the restrictions under which it does operate should be changed - it should still exist and should play an ever larger role in foreign investment but should be able to act to achieve more without having to go through a lot of government departments.

Mr KIRKE - Iwould just like to make a comment. Apropos the Minister this morning protested the private sector did not come close enough to Government and express our views or were not strong enough in our

Mr KIRKE (continuing) - actions apropos NIDA. It is rather strange - the Government has not seen proper to fill the two existing posts on the NIDA Board with representatives from private enterprise.

Mr NOU - Yes, it does - Mr James Seeto is a representative on NIDA Board, representing the private sector.

Mr KIRKE - I did not say they did not have one - I said they should fill the two vacancies with two more.

Mr NOU - That is not my area.

AGENDA ITEM 6

A discussion of policy issues in relation to foreign investment policy in the manufacturing and service sectors and an outline of options open to the government in further developing its policy on foreign investment in these sectors - Mr P Daniel

Prof CLELAND - You mentioned there has been a dictation of national strategies which vary from import substitution, export creation and employment. There is also a growing tendency in economic literature to talk about national strategies becoming employment strategies - bearing in mind we are looking at a half a million unemployed school leavers in the next 10 years in Papua New Guinea, how do you see this in relation to foreign investment and motivation?

Do you go along with the fact our national strategy must be in great measure dictated to by the employment situation, bearing in mind the realities of the situation in the next few years - what role do you see foreign investment playing and what attitude?

Mr DANIEL - I do not think it should be dictated by the employment situation narrowly defined. I think it should be dictated by the availability of incomes to the population when referring, for example, to that part of the population which is engaged in subsistence agriculture does not make a great deal or: sense; to talk about improving their living standards and availability of incomes to them makes sense.

Mr DANIEL (continuing) - Regarding employment creation in urban industries, and foreign investment, I would myself be inclined to play down at the present time employment creation as an argument for industrial development. There are a couple of reasons - firstly, we do not know enough about the nature of the urban unemployment. We all know there are urban unemployed, but we do not know why, and we do not know how many have absolutely no alternative, and how many are here because they want to be, and find it attractive, and will give it a try for a month or so. Insofar as we have completely trapped people in urban areas, it will be necessary to think about urban job creation. As far as other groups are concerned, those who perhaps need an air fare back to the rural area, or are merely giving urban life a try, perhaps other measures are appropriate. I think at the present stage we ought to treat that with a certain amount of circumspection - you cannot justify particular investment proposals on the grounds that they create employment alone. I feel they must be justified on a lot of other grounds.

Mr McCLELLAN - On the question of the unemployed half a million school leavers in five to ten years - that is a fairly alarming picture to be facing. The answer you just gave is not to establish job opportunities. Do you not think that is just avoiding the problem at this stage.I think it is a solution we should start to solve now, not in five years or ten years time when you have a monster on your hands.

Mr DANIEL - I agree. I did not sya we should not create jobs. I argued against the idea we should attach such weight to employment creation. For example, public expenditure proposals which may make massive provision of employment but which make a negative contribution to everything else, are not perhaps justifiable.

Mr MILLET - You mention in this a rather sophisticated complex system of evaluating. You are required to put weights against different objects. Who decides what those weights will be and what criteria do they use to determine what the weights will be? I rather suspect it is a political decision and that therefore the criteria are political criteria, which is very often job creation.

Mr DANIEL - We will know the answer to one part of that question on August 9.

Mr MILLET - Would you say there is some lack of communication between the political leaders and the policy level?

Mr DANIEL - I think certainly the record over the last five years here, which I am observing as a newcomer from the outside, suggests that cooperation between the politicians and economic advisers is extremely good.

Prof. CLELAND - Is it that politicians tend to hire economic advisers that agree with them!

SITTING SUSPENDED FROM 3.00 to 3.20pm

AGENDA ITEM 7

A review of the problems confronting a large extractive investor who is contemplating a major project - Mr R Burge

Mr BURGE - I would just like to mention that this is a feasibility study it is not to be construed that it is automatic that Ok Tedi will go ahead. My personal view is that I would like to see it happen. I believe that if it is technically and economically feasible it would be a great thing for Papua New Guinea. The amount of contained copper that is in the deposit, as far as we know, is approximately about half or may be less of what is left in Bougainville and that will give you some indication of the possible size of the mine. We are looking at a proposal for handling 40 thousand tonnes of ore a day which means we will have a removal of about 120 thousand tonnes a day.It will be a big mine, but not as big as Bougainville. I must stress we are doing feasibility studies, there are many things like we have transportation up and down the Fly River, electricity for quite a substantial, town, education, the general well being of the populous of the area being looked after and cared for. I hope that i would have cause to continue to return to Papua New Guinea for many years from now.

Mr McLELLAN - After the completion of the feasibility study, which you say is May 1978, how much longer after that is it likely that a decision will be made?

Mr BURGE - I think I said 1979. There is then a 12 months period before

Mr BURGE (continuing) - the finalisation of the whole thing. If it is a go, we then have 12 months to find finance, arrange finance, write up the small print and all the agreements that will be necessary. So you are looking now into 1980.

Mr FLYNN - You mention transportation of the ore and that you were looking at both the Highlands Highway and Fly River. Is that the situation?

Mr BURGE - If the mine was closer to the sea we probably would not have a lot of problems deciding to go ahead, but it seems that very few ore bodies are near a capital city. You are about 450 miles up the Fly River and then another 70 miles by road to get to Mt. Fumulu. We have looked at hovercraft, 747s, you name it. When you do a feasibility study it may sound ridiculous but what would we have in ten years time, so the practical way is by road and down the Fly River or a slurry pipeline. We will be using a tremendous amount of fuel for the trucks so a surface pipeline into the area is going to be necessary anyway and it will be very difficult to take in 120 tonne trucks by helicopter. So you have to have some transporation services in barges up and down the river, for fuel and supplies to the town. So they are the two types of systems. Where we build an ocean port will have to be decided.There is one suggestion that we bring a pipeline through to Daru. Daru is already established, it has its own airstrip. There are people doing that sort of thing. We are surveying the Fly River and we even lost a ship on that.

Mr THURECHT - Pre-empting the feasibility study and assuming that you go ahead with this scheme, which we will all be very grateful for, but there are problems that the private sector had following the establishment of Bougainville mine and I would like your answer, even though I know what they are, or assurances of how you will be handling these problems. Firstly, when Bougainville Copper was first commenced we were assured of no pilfering of staff presently working for the private sector - that did not happen, for a very good reason, that Bougainville Copper then paid wages that the rest of the private sector were incapable of handling. As a direct result Arawa would be the most expensive town in Papua New Guinea

Mr THURECHT (continuing) - both to live in and build in. During the initial stages of Bougainville Copper the Government of the day in its wisdom gave it certain duty free entree to the goods in the country and they utilised this to purchase overseas and locally when they had not other means or could not get it. I believe this situation is changing greatly now but there is still quite a lot imported into Bougainville on behalf of the mine that we feel could be purchased by local entrepreneurs.

Mr BURGE - Both these points are not new to us. We have had staff pilfered from BHP for 50 years. We know the problems. If you look at some of the remote towns in the Pilberra some of these people are getting fantastic money.

On the purchasing locally, BHP representatives here today number about 10 percent of the population of this room who come from BHP and we have a number of businesses in Papua New Guinea and I think the remifications of BHP should be well known through Papua New Guinea Industries, AWA, ARC and we are very well versed or I hope we are in the problems and we hope we are learning more of the problems you have in this country and collectively in the BHP organisation through gentlemen like Mr Darling, the welfare of Papua New Guinea is in our hearts and we would not like to come into this country and disturb it and cause a lot of trouble. I think you appreciate that this country is attempting to prove to the rest of the world that you are a developing country receptive to foreign investment and if we are host to that kind of thing we hope to show the world it is a good place to invest. It cannot be an economy that is dependent on a few instances or a few mines like Ok Tedi, it has to be an economy that is balanced. We talked this morning about wheeler-dealing. With Ok Tedi we have 130 pages of material dealing with ocean river ports, the building of towns etc but all of these related to that particular project but this is nevertheless necessary for all of those particular facets of life over there to be in that agreement. The Papua New Guinea Government in their wisdom are going to continue with negotiations of that type. I do hope that each and everyone of you bring forward to us any of the problems you see. I think we have been in the game long enough to be as flexible as the people of Papua New Guinea have been.

AGENDA ITEM 9

Summing up and Overview - Dr B Shaw

Dr SHAW - I have a rather difficult task because I have to do, off the cuff, what a number of people have been doing this afternoon and this morning having given a great deal of thought to what they said. I do not want to add anything new, but rather to draw together some of the threads, and also to suggest some policy areas and practical areas for future investigation and action both within the Government and within the private sector.

First of all, I think a very great achievement of this seminar today can be seen in what was not said, rather than what was said. It could have been possible to have this as a scene of NIDA knocking, bureaucrat bashing and politician prodding and I am delighted, and I am sure you are too, that this has not happened and that criticism has been very constructive. Also the Government and the private sector have participated very readily in the seminar. For that reason I hope that the tenor of the Minister for Finance’s speech this morning on the private sector and the Government having some dialogue and really talking to each other is followed through. This is something I will comment on later, in relation to the future activities of the Institute of National Affairs.

This whole problem of foreign investment can never be dealt with in a day like this. We have scratched the surface and found the can of worms and I hope because we have been nice to each other and some very pleasant things have been said today, that we are not lulled into a feeling that the whole problem is under control, or that the problems have been solved. The size of the problem of foreign investment can be indicated by a few extremes. For example, BHP, who are partners in Ok Tedi, have an annual turnover of perhaps three or four times that of the Papua New Guinea Government. The size of the larger multinational companies tends to make some governments very jittery, they then make decisions which are not very carefully thought out.

Dr SHAW (continuing) - At the other end of the scale, and accounting for a large part of foreign investment on this country, are people like Brian Bell over here who has a paid up capital of 21t! He is, like many small businessmen who have come to Papua New Guinea who may be now naturalised citizens, but who are still basically foreign investors.

Looking at a bigger scale still, you have countries like Burma which has virtually prohibited foreign investment for the last 10 or 12 years, and people point to Burma and say "You have a run down economy, that is because of not allowing any investment". Then you have countries like Indonesia which in the last six years has increased the amount of foreign investment by about six times and people are pointing at Indonesia and saying "Look at Indonesia, they have not properly evaluated the costs of foreign investment, they are trying to get too far too fast".

There are big and small foreign projects and there are many things which need to be evaluated and things which need to be thought out carefully.

The Minister for Finance this morning said that free enterprise must be enterprising. This is obviously very important - and in being enterprising it must also do something else and have dialogue with thc} Government.I would like to think this Seminar has been the beginning of such a dialogue rather than dashing off something rather ill-thought-out to the "Post Courier". There are a number of issues which have already been covered today on which a good dialogue between government and business could take place in future.

The Minister also said that free enterprise should be adaptive, and it should adjust to what is going on in Papua New Guinea and what Papua New Guinea. wants. This gets on to an area which is very trendy and this is appropriate technology. This is also something private investors from overseas need to think about carefully; the appropriateness of their activities, both in terms of scale and types of things they do in this country. Being appropriate for Papua New Guinea may require adapting their operations to fit this country's requirements.

Dr SHAW (continuing) - Mr Elias in his paper brought out some things which bear thinking about a great deal because what he did was to show that the problems of the foreign investor are very similar to problems of the domestic businessman. They both have the difficulties of a small market, poorly developed infrastructure, a high import content for a lot of manufactured articles, they face the same labour market, and so on. They also deal with the same Government, and I think it would be very important for the Institute of National Affairs and for other bodies that exist within the private sector to ensure that the sorts of problems they talk about to Government, are those of the entire private sector, both national and foreign. I think a lot of what has been discussed today applies also to Papua New Guinean businessmen.

The question of protection for local industry is a problem: the competition with dumped products or products which come in under marginal pricing to Papua New Guinea is a problem and it is not unique to foreign investors.

Some of the comments made by Mr Agonia, who read Mr Lawrence's paper, were also interested because minerals mining policy in Papua New Guinea and in relation to foreign investment is most well developed. In this seminar there has been a fairly heavy concentration on the area of exploitive industries. This may be a bad thing in that it did not focus enough attention on the smaller investors, both domestic and foreign, in Papua New Guinea. But the way in which minerals policy and extractive industry policy has developed in Papua New Guinea might give us a clue to the way new policies might develop in future.

In the case of Bougainville Copper, the Australian Government negotiated one agreement - it did not have a mining policy at the time. The same is true of a number of timber agreements. Later, things were felt to be wrong, and the agreement was renegotiated and in doing that certain things were learned by both the Government and the company. Out of this - and also in negotiation with other mining companies -

Dr SHAW (continuing) - a policy forms. In this way, a case by case approach evolves into a mining policy.

I think one of the problems with NIDA is that it has not been able to date to develop many general policies in relation to specific sectors. It is still proceeding on a case by case approach. It may in fact be using bureaucratic devices to work out general policy through a case by case approach. Dr Palmer asked "Do we want a case by case approach or do we want a general policy?" I think that you begin with the case by case approach and it develops into a general policy and then you find things go wrong with it and you form "sub policies" and the process goes on and on. Policy must remain flexible and continually evolve. I see that sort of development going on in future.

The comments which Mr Bendall made were those of a foreign investor and somebody who has been here for some time, indicated some of the confusion that still exists both in the private sector and the Government in relation to foreign investment. The Minister in his speech said foreign investment is not worth anything unless you know what you want - foreign investment itself will not necessarily contribute anything - it has to do something for Papua New Guinea.

NIDA itself, as Mr Bendall pointed out (I have in my notes "said with feeling") has some conflicts between its role as encourager of foreign investment, its role in controlling foreign investment which is already here, and its role in prohibiting certain forms of foreign investment which it regards as undesirable. I would not wish those sorts of roles on anybody and I am delighted that NIDA as an institution was not shot down in flames, because it has developed it has some very severe conflicts in those sorts of roles. Future policy in relation to private sector foreign investment should, I think, try and resolve some of these conflicts.

I also liked Mr Bendall's comments about "foreigners" in the Provinces because it does indicate that foreign investment is something that generates an awful lot of heat and light is often a little absent.

Mr Daniel of the National Planning Office also emphasised some of the Government's policies, but the important thing he

Dr SHAW (continuing) - raised was consistency of approach and evaluation. As was said earlier by Mr Bendall, you really want to know what the ball park is you are playing in. You want to know the rules. Then there is room for negotiation:- this is of utmost importance. The general feeling, I think, of the Seminar can be summed up in some of Mr Burges' comments that the Papua New Guinea Government has got more mature in dealing with foreign investors that it is a good Government to talk with and a good government to talk to. I suggest that more and more it should be talked to and it should be talked with and that the future development of the private sector should be a hand in hand process.

Something that has not been discussed and which is a very thorny problem in relation to foreign investment is what economists call externalities: -- a project may create costs or benefits to a country which are outside that particular project. Taking Ok Tedi for example, there are the problems of pollution of the Fly River, social problems of the people in that area and the problems of disposal of waste. Some of these problems may create costs to the Papua New Guinea economy and the society. On the other hand you will get improved transportation up the Fly River, which will benefit the people of that area in many ways. This transportation will not cost the country anything but it does yield value to the country. A company may want to invest in Papua New Guinea but in itself the project looks like a "rip off". Yet it may provide a vital link in some kind of infrastructure or it may be very important to production of other products. So projects cannot be evaluated just on their own. They may have costs and benefits which accrue outside it.

I thought that we might finish with a few comments about the Institute of National Affairs and where it might go. Some of these I have mentioned already but although there will be further discussion and people may wish to add something further, I think they sum up the things that have been said today both in relation to foreign investors and the private sector in general. These directives are fairly rough, and I have just scribbled them in the last few minutes, but they are the sort of things I think the Institute can do.

Dr SHAW (continuing) -

1.Increase the dialogue between the Government and the private sector, both national and foreign, by ensuring that its research projects are relevant to the needs of both sectors.

2.Research the short and long term benefits and costs of foreign investment in various sectors in Papua New Guinea and assist the Government to continually improve its methods of assessing, encouraging and controlling foreign investment.

3.Investigate the possible role of incentives to foreign investors in certain sectors, especially those forms of investments which will yield benefits to the country beyond their direct contribution to the economy.

4.Study the effects of localisation in the private sector with a view to assisting the government in its efforts to make localisation rapid yet meaningful.

5.Identify constraints to the development of the private sector, both national and foreign. It is especially important to identify those constraints which apply to all investors, domestic and foreign.

Those are rather brief but I hope they might be an indication from this group where the Institute of National Affairs might go.

I will end with one really thorny problem and that is the question of time. This has been brought up by a number of speakers; if you have investment now you do not really know what is going to happen in the future. You will have some risk - and the risk is partly the Government's and partly the investor's. The Government may think "If we give this company a tax holiday, in two years time it will be at a point where it does not need the tax holiday and two years after that it will repay the cost of setting this thing up." But the outcome may prove to be different. These are complex problems and the knowledge of the way in which investments develop over time is something which is relatively ill-developed and I do suspect that some evaluations of smaller foreign investors in Papua New Guinea are rather static. In foreign investment, risks must be taken by Government as well as foreign investors.

Dr SHAW (continuing) - With that I will finish what is a summary and overview of what has been said.

I think this has been a very mature and worthwhile discussion. NIDAs absence has been to their detriment and it has not really worried the seminar too much. On behalf of you all, just as an observer, I would like to thank all the people who gave papers and hand you back to the Chairman if any of you have any more questions.

Prof CLELAND - It seemed to me that one clear problem that may emerge from today is the role of NIDA and the image of NIDA and I believe I would like to support Mr Bendall's comments that NIDA has two faces - it is a regulatory policeman's role and it is also trying to have a marketing role. What is it? What should it be? Should it have to be divorced so it can act as a facilitator or a clearing house, someone you can go to and know you will get the assistance to do the job you need. I think it was a Government person suggested that we should consider setting up a working relationship with NIDA to help in this situation. Why do we not offer this possibility. That is merely a thought. Perhaps there are some more thoughts on this.

Mr R KUMAINA - I would like to make a brief comment which I hope that the Institute might take into account. In attending the seminar today I have heard a lot of fruitful discussion, except it is a pity we do not quite know what is going to happen on 9 August. However, I do think that discussions have highlighted a number of problems we have faced in a short space of time since the establishment of NIDA. I think we intend to look at the situation more realistically as far as the life of the next Government is concerned within the period of the next five years. In the past I believe that the private sector and many of your here will agree, it has never been consulted by Government on policy making such as to do with investment and so on. I would suggest to the members who are here that the Institute should realistically look at the problem the next government might be likely to face with a view to making constructive suggestions to the next government and I will go as far as suggesting that perhaps there should be a lot more participation from private enterprise - not so much in the regularity aspect of NIDA but more so in the framework of the

Mr R KUMAINA (continuing) - size and marketing side of investment to Papua New Guinea. I think it is fair to say that those of you who are involved or have been involved in business in Papua New Guinea have a lot to offer and I do not think the Government denies that except I think the minister came out this morning by saying he welcomes a lot more dialogue and I feel the Institute will do well to act fiarly quickly in trying to move in, to be heard a little bit more in so far as participating in a body such as NIDA.

Mr KIRKE - There is one thing that concerns me about the role of NIDA and I agree with Mr Bendall's suggestion that it does not have enough power. I was a little frightened this morning when I heard of the incentives offered by Queensland to induce foreign investment. I know of one instance where a businessman from here was enticed by Mr Bjelke Petersen to set up a business down there. I think he was given the land and was also assisted by the government in financing the building of the factory. That can only be done if the government has laid down its policies and defined what it requires to be done in its own area. Until our Government does that I think NIDA will not be able to work properly. That is one of its major roles or should be. Priority schedules are one thing. Somebody comes and reads the schedules and finds that there is no information available. That should be one of NIDA's roles and I do not know whether it is fitting for INA to go and do that. I agree that NIDA should have more instant power.

Mr CAVANAUGH - I think one thing we can look at is the hidden cost to the industry, the cost of land, the cost of royalty etc. The cost of land has more than doubled in the last five years and the cost of royalties in the Chimbu district has doubled between 1972 and 1974. The labourers wages have increased out of all proportion without any relationship to work being done by them. I think you will find a tremendous area in which industry feels it is being ripped off and it is creating quite a bad impression. In signing a contract with the government, one side is open and the other side is sealed so that the government can make its own figures after the contract has been signed. Some of these factors do tend to make

Mr CAVANAUGH (continuing) - people just walk away. I was in New York recently and some people asked me questions about investment and I had to answer the questions and they said that the government would have to get mature enough to sign both sides of the contract before they would come with investment.

Mr NOU - May I suggest that another seminar be arranged on the topic of investment seeing as we are talking about NIDA.

Mr THURECHT - One point that I think which has been missed and this is expropriation. I think that is something that has not hit industry as such nor the urban areas but I think we are well aware of what has been going on in the rural areas where plantations, sometimes rightly, sometimes wrongly, have been expropriated and I believe it is getting a little closer to home and maybe we should be bringing influence to bear on the effects of expropriation on the government's foreign policy.

Mr WOODWARD - I think Mr Nou's suggestion that there is some continuation of this sort of discussion is a good one. I would like to suggest it be convened between a group from the private sector who have had experience dealing with the government who I am sure could come along and argue on a list of items they think is lacking in the government's handling of the private sector generally - with a relatively small group of people from the appropriate operative departments who have the actual handling of investment.

I think everyone acknowledges the policy has to be developed before we can really run a programme properly but when you have the policy it must be administered properly and I think in getting down to the nitty-gritty details we have tended to overlook this because we have not had the time.

I think this will contribute a lot to the formulation of policy which after all as Dr Shaw said cannot remain static and must be reviewed in the light of experience and I think a working level seminar can do a lot in this regard.

CLOSING REMARKS BY THE PRESIDENT OF THE INSTITUTE