

COMMISSION OF INQUIRY INTO  
ASPECTS OF THE FORESTRY INDUSTRY

FINAL REPORT

VOLUME II

JULY 1989

Prime Minister's  
Dept.

COMMISSION OF INQUIRY INTO  
ASPECTS OF THE FORESTRY INDUSTRY

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#### 4 FUNCTIONS

FUNCTIONS OF THE DEPARTMENT OF FORESTS, THE MINISTER FOR FORESTS, THE FOREST INDUSTRIES COUNCIL, PROVINCIAL GOVERNMENTS AND THE NATIONAL EXECUTIVE COUNCIL.

##### Term of Reference No 5

"5 What are the functions of the Department of Forests, the Minister for Forests, and the Forest Industry Council (sic) within the government policy for the forestry industry"

##### Preliminary Observations

In the absence of a comprehensive and authoritative government policy it is by not really possible to state authoritatively the functions of the Minister, the Department and the FIC "within the government policy for the forestry industry".

Similarly the legislation relating to forestry pre-dates any real effort to formulate a current policy. That legislation therefore does not reflect, let alone implement, any stated policy.

My first observation, therefore, is that it is not possible to comment on this term of reference in the context of the stated "government policy for the forest industry". I will however discuss the functions of the above mentioned officials and bodies in the context of the "defacto policy" described in Section 3.

I am firmly of the view that the Department must have, and efficiently perform, a function of gaining information in relation to such matters as current prices in the international market and the prevailing marketing practices.

In broad outline the functions of the Department would include the following:

1. To ensure that all aspects of the relevant legislation are administered properly and to advise on experienced field staff.
2. To formulate and once approved, to implement a comprehensive forest policy.
3. To provide advisory services to government agencies, including provincial governments, in the fields of forest development and regulation.
4. To use its expertise to assess all scientific and environmental aspects of the industry to ensure that the resource may benefit future generations and that the environment does not suffer undue or irreversible damage.
5. To be familiar with international practices and trends in the timber industry, most notably in the fields of pricing and marketing.
6. To properly advise the Minister in respect of each application and to recommend appropriate covenants and conditions. It should be honest and forthright advice - not merely telling the Minister what he wants to hear.
7. To ensure that covenants and conditions are up dated and are, at all times, complied with and to take immediate and decisive action in the event of their breach.
8. To recommend appropriate amendments to the legislation and to ensure that the legislation gives proper effect to the approved policy.

My second observation is that the term of reference omits to mention the role played by provincial governments and the National Executive Council. I intend to make reference to the responsibilities of these two authorities in order to give a complete and meaningful statement of their functions.

A. POWERS AND FUNCTIONS OF THE NATIONAL EXECUTIVE COUNCIL

1. Constitutional Responsibilities

The principle of collective responsibility is enshrined in section 141 (b) of the Constitution. This provides that members of the Ministry are collectively responsible "...for the proper carrying out of the executive Government of Papua New Guinea".

Accordingly the functions of Council may be said to include the following:

1. To ensure that the Department for Forests regularly and accurately briefs Council as to matters of concern in the forest industry and any matter that affects the interests of the State.
2. To ensure that the Department of Forests is functioning properly and is efficiently discharging its responsibilities.
3. To ensure that the Departmental Head is ably and properly administering his Department and, if necessary, to act to remove him.

4. To ensure that the exploitation of the forest resource is carried out in accordance with the principles stated in the Constitution and is in the best interests of the nation. The Council should ensure that there is a comprehensive and up to date policy which can serve the nation's interest.
5. To approve necessary legislative amendments and to steer their passage through Parliament and more up to date, appropriate, effective legislation is in place on a continuing basis.
6. To scrutinize and approve any major contract that will bind the State and have major implications for the nation.
7. To advise the Head of State to sign contracts such as project agreements and shareholder agreements on behalf of the State.

2. Powers and Functions conferred by Acts of Parliament

Under the Forestry Act, the Forestry (Private Dealings) Act and the Forest Industries Council Act, the Head of State acting on the advice of NEC has power to make regulations on a very broad range of matters. It is a clear function of the Council to ensure that the Regulations made under these Acts are adequate and up to date.

Under the Forestry Act the Head of State, acting on advice, can dedicate government land to be a national forest (section 6) and has power to approve the granting of a lease or licence in respect of such areas. (section 9). Under section 14 the Head of State, acting on advice, can declare a major forest enterprise for the purpose of reafforestation.

Under the Forestry Regulation the Head of State, acting on advice can cancel a permit (regulation 15(3)) and approve a tramway (regulation 34).

The power to advise cancellation of permits or licences was delegated to the Minister for Forests by NEC Decision No 132/86 on 16 October 1986.

The Head of State, acting on advice, can declare a prescribed authority to certify that parties to a Dealing agreement have the right to sell or dispose of timbers in relation to proposed operations in a Local Forest Area declared under the Forestry (Private Dealings) Act.

## B. POWERS AND FUNCTIONS OF THE MINISTER FOR FORESTS

### 1. Constitutional Functions

The effect of Section 148 of the Constitution is that the Minister is "politically responsible" for the operation of the Department and the administration of its functions. It must be stressed that it is specifically stated in section 148 (3) that this political responsibility "does not confer on a Minister any power of direction or control".

This is contrary to a recommendation in Chapter 4 of the Final Report of the Constitutional Planning Committee which stated:

"46 We propose that a general system of government departments be maintained. Accordingly, we have provided for each department to be under the direction and control, of a Minister, and subject to that direction and control, under the supervision of a Head of Department".

The extent of the Minister's "political responsibility" was concisely stated by the Deputy Chief Justice in S.C.R No 1 of 1982; Re Bouraga [1982] PNGLR at 96 in the following terms:

"What is the political responsibility of the Minister?. The term is not defined. In my opinion the political responsibility of the Minister involves:

- (a) all matters concerning a department, section, branch or function of government which require the deliberations or decision of the National Executive Council as a matter of responsibility of the National Executive Council as the executive government of Papua New Guinea. (See s. 149(3) of the Constitution.) It would be the political responsibility of a Minister of the particular department, etc., to submit, advise, inform, report or brief the National Executive Council to enable the National Executive Council to make decisions as the executive government of Papua New Guinea regarding the particular branch of government. This would include such matters as budget priorities and allocations.
- (b) inform, report or answer questions in the Parliament or the public through news media regarding any matter concerning the functions of the government as a member of the Cabinet which is responsible for the executive arm of the Government.

This responsibility is more in the nature of doing the groundwork for the National Executive Council for purposes of Executive decisions under s. 149(3) of the Constitution and simply informing the public through Parliament or news media of the workings of the executive arm of the government or the particular branch or department of government. That is as far as the political responsibility of a Minister can go."

It is abundantly clear that the constitution does not confer powers on Ministers. They are stated to be bound by "political responsibilities" and one must not lose sight of the fact that emphasis is to be placed on the word "responsibility".

The decision in Bouraga's Case, however, makes it quite clear that while the constitution does not confer powers of direction or control on Ministers there is nothing to prevent Acts of Parliament from doing so. Indeed it is the ordinary Acts of Parliament relevant to forestry matters that are the source of the Minister's broad powers.

Contrary to most people's perceptions and to most Minister's expectations the Constitution does not confer on Ministers overriding and all-encompassing powers. The constitutional responsibilities are onerous but Ministerial powers are confined only to those conferred by law.

## 2. Minister's Responsibilities to the National Executive Council

In accordance with the principle of collective responsibility and to ensure the proper functioning of the executive government the functions of the Minister can be said to include:

1. To keep NEC advised of all major developments in the forest industry and of matters that affect the interests of the State.
2. To recommend necessary legislative amendments and, once approved, to ensure that they are ready for presentation to Parliament.
3. To ensure that adequate, relevant and up to date Regulations are made by the Head of State, acting on advice.
4. To ensure that a comprehensive policy in the nation's best interests is formulated and submitted to NEC for approval and amended as required.
5. To answer to NEC for any failure in the administration of the Department or the discharge of its functions.
6. To ensure that any proposed contract to be entered into by the State gives adequate recognition to and protection of the nation's interests.
7. To carry out and to ensure that the Department carries out any direction of the NEC.
8. To implement and to ensure that the Department implements Government policy as it applies to Forestry and to his other ministerial responsibilities.

The Determination of Titles and Responsibilities of Ministers appearing in National Gazette G49 on 15 July 1988 states that Karl Stack as Minister for Forests is responsible for "all matters related to the functions of the Department of Forests". This cannot be read as conferring any power but merely clarifies that the extent of the Minister's "political responsibility" is limited to the functions of the Department of Forests.



### 3. Powers conferred by Acts of Parliament

By the Determination of Titles and Responsibilities of Ministers the Minister for Forests is vested with the responsibility for exercising Ministerial powers under the following Acts:

- Forest Industries Council Act  
(except ss 6 (7) and 11 (6))
- Forestry Act
- Forestry (Private Dealings) Act
- Local Government Act  
(Section 91 only)

The scope of the Ministers' powers conferred by these Acts is extensive. The Minister has not only the final say but the sole and exclusive say on nearly every aspect of the control, regulation and promotion of forest exploitation.

The extent of these powers is clearly more consistent with the centralised power structure of pre-independence government in Papua New Guinea than the present policies favouring decentralization and separation of powers.

A summary of the Ministers sweeping powers under the Forestry Act and Regulation, the Forestry (Private Dealings) Act and the Forest Industries Council Act is contained in Schedules 1, 2 and 3 to this Part.

It must be remembered that, in exercising his powers under legislation, the Minister is bound by any overriding duty or limitation imposed upon him by the Constitution and is expected to exercise his statutory powers in accordance with "the spirit" of the Constitution and in a way consistent with the collective responsibility of the National Executive Council.

Department  
of Forests

1. Administer legislation pertaining to forests.
2. Forumulate policy proposals and implement approved policies affecting forestry development, and activities, including training, management and marketing of forest resources.
3. Provide advisory and technical services to Government, Provincial Governments, and procedures (sic) and consumers of forestry products.
4. Understake (sic) scientific research into land use for forestry development, and botanical and ecological investigations.
5. Maintain a watching brief over policies and plans of international bodies dealing with the foresry industry.
6. Supervise major national forestry development schemes.
7. Provide services to ad hoc and other oranisations relating to the functions of the Department.

The functions are self-explanatory and are in keeping with the functions I would expect to be exercised by the Department. I note in particular, the obligation to formulate and implement policy. As I have observed on many occasions the Department has been remiss in not according this the priority that it clearly warrants. Similarly, the responsibility for undertaking scientific research into the extent, nature and rate of regrowth of the resource has not been exercised adequately.

The Minister is of course also bound by the overriding provisions of the Organic Law on Provincial Government which treats Forestry as a concurrent power.

In the exercise of these powers it is the responsibility of the Minister to be fully informed and to act only on proper and relevant considerations. The Minister must seek the views of his Department and, if necessary, ensure that the Department properly and professionally considers every relevant aspect and advises accordingly. It may be that the Minister should also seek views from appropriate persons outside the Department but such views must come only from suitable persons and must assist the Minister to make a proper decision in all the circumstances.

## C POWERS AND FUNCTIONS OF THE DEPARTMENT OF FORESTS

### 1. Generally

Section 20 (1) of the Public Services (Management) Act 1986 states:

"the functions of each department, other than the Department of Personnel Management, are as determined by the Head of State, acting on advice, given after consideration of reports made to the National Executive Council by the Department of Personnel Management and the Public Services Commission".

By notice published in National Gazette G83 on 31 December 1986. The following determination was made in respect of the functions of the Department of Forests:

9. To ensure that the State is properly represented in all negotiations for agreements and that the State protects the nation's interest and the interests of those people who the State is obliged to protect (eg. landowners and local industries).
10. To liaise with other agencies to effectively implement policy and conditions.

#### General Responsibilities of the Departmental Head

Section 23 (1) of the Public Services (Management) Act is restated in General Order 11 of the Public Service Standing Orders and reads:

"11.1. The Departmental Head is responsible for the general working and efficient conduct of his department".

Clearly the Departmental Head is ultimately responsible for ensuring that his Department properly performs all its functions as listed in the previous section and all other functions and responsibilities that fall on the Department.

Under General Order 11.3 the Departmental Head is required to submit an annual report relating to the working of his Department and containing matters required by the Department of Personnel Management.

I have ascertained that the Department of Forests has submitted no reports. There is clearly little prospect of effective supervision of a Department if it is unwilling to divulge information as to its activities, general administration and performance.

However, I note that the Department of Personnel Management appears to have failed to specify the matters to be included in the report. It appears, therefore, that the blame for non-compliance must be shared, to some degree, by both Departments.

The final area of general responsibility of the Departmental Head concerns financial accountability in his Department. Section 5 of of the Public Finances (Management) Act vests specific responsibilities in the Departmental Head. These generally cover the responsibilities of ensuring proper financial accountability and compliance with stated procedures and instructions and also the accountability of the Department to the Parliament through the Public Accounts Committee.

### 3 Legislative Powers and Responsibilities

The Forestry Act, The Forestry (Private Dealings) Act and the Forest Industries Council Act do not specifically vest powers in or specify functions of the Department. Broad powers of a basic administrative and enforcement nature are given to Forest Officers and Forest Inspectors but all other powers and functions are given to the Minister.

The Regulations made under the Forestry Act give secondary powers and responsibilities to the Departmental Head.

A summary of the powers and responsibilities of the Departmental Head under the Forestry Regulation is contained in Schedule 4 to this Part. The powers given by the Act and Regulations to Forest Officers and Forest Inspectors are listed in Schedule 5.

#### Powers Under Permits and Dealings

The Secretary also obtains extensive powers under Permits and Dealings which are regulatory and day to day control powers

#### D. POWERS AND FUNCTIONS OF FOREST INDUSTRIES COUNCIL

The Forest Industries Council was established by Act of Parliament prescribing its prime function and duty to be the promotion and development of the forest products industry. Under Section 21 of its Act the Council is given the power to register persons as forest product operators. This applies to all persons carrying on the business of logging, sawmilling, processing or marketing forest products.

The powers of the Minister are listed in Schedule 3 and the powers of the Council are stated in Schedule 6.

The Forest Industries Council was fully investigated by this Inquiry and the results of this investigation are contained in Interim Report No 3.

Indeed it was the circumstances surrounding the activities of the FIC which directly led to the establishment of this Commission of Inquiry.

Matters leading up to FIC's entry into the field of marketing, its activities in this field, and the role played by Michael Cowan, Miskus Maraleu and others are fully covered in Interim Report No 3.

It need only be said at this time that the FIC, at the instigation primarily of Michael Cowan, became actively involved in marketing without final any legislative basis for becoming so involved and without NEC approval. Moreover, it became so actively involved in marketing that it completely overlooked the real purpose of its existence. It was an organisation established with the primary function of promoting and developing the forests products industry and it did this to only a very limited extent.

#### E. PROVINCIAL GOVERNMENTS

All laws relating to forestry in Papua New Guinea were enacted prior to the passing of the Organic Law on Provincial Government and the establishment of provincial governments. Accordingly, provincial governments and their staff are accorded no recognition whatever in these laws.

Forestry is a concurrent function under section 27 of the Organic Law on Provincial Governments and provincial governments are therefore empowered to enact legislation relating to forestry provided that it is not inconsistent with an Act of Parliament. (Section 28).

Provincial governments must be consulted in relation to any proposed Act of Parliament relating to forests and notice of any proposed Act must be given to all provincial governments not less than two months before it is made. (section 30 and Section 31 (4) respectively).

Apart from these provisions provincial governments are given no constructive role in the development or regulation of forests in their provinces.

In some provinces officers of the provincial government have been appointed as Forest Inspectors. This has created very real problems of its own. As the provincial government has no powers under any of the laws it cannot direct its own officers to perform any particular function. Such power rests only in the National Government Department which has no power of discipline or control over the officer as he is an employee of the provincial department. It is inevitably an intolerable situation where an inspector cannot be directed to perform his responsibilities by his own superiors and where the persons who can direct him to act in a particular fashion can take no action against him if he chooses not to do so.

In some cases provincial officers have been appointed as the prescribed authority under the Forestry (Private Dealings) Act to certify that parties to a proposed agreement have the right to sell or dispose of timbers. There has been no consistent policy in this regard. All previous appointments of Provincial Forest officers have been retracted. Recently the Minister for Forests appointed the Deputy Premier for Manus to be the prescribed authority and I am of the view that this action is improper (See Interim Report No 5)



In the light of all these matters it is not surprising that very real tensions between provincial governments and the National Department and the Minister for Forests sometimes arise. Examples of such tensions include;

- . The early objections by the Western Provincial Government to the allocation of a permit to the Wawoi Guavi Timber Co. It briefed a lawyer to formulate its objections strongly (IR No 5 App 1).

- . The conflict between the Gulf Provincial Government and the National Minister over the proposed declaration of Turama LFA which finally resulted in a political compromise whereby the Minister issued a tasty and premature timber permit to Long Term Trading Company Pty Ltd in violation of normal procedures.

- . The bitter correspondence between the National Government and the East Sepik Provincial Government over the declaration of a Local Forest Area in lower Sepik in an area already the subject of an Australian aid funded feasibility study.

Recently the dispute between Manus Provincial Government and Minister Stack resulted in protracted litigation and prompted the Manus Provincial Government to enact its own Forestry Act pursuant to its powers under the Organic Law.

(The Turama, Lower Sepik and Manus LFAs are all discussed in IR 7).

There is a very clear need for sweeping legislative and administrative reforms to be effected to properly recognise the role of provincial governments and to ensure that the existing anomalies relating to staff and other administrative matters are overcome.

### CONCLUDING REMARKS

The functions and powers given to the Minister for Forests, the Department of Forests, the Forest Industries Council and Provincial Governments by the various Constitutional Laws and Acts of Parliament bear little relation to any principle of forestry policy. The following may be identified as important aspects of such a policy:-

1. Decentralisation of the Forestry Industry to an extent sufficient to satisfy legitimate demands from the Provincial Governments for involvement in decisions affecting the provincial economy.
2. To promote the orderly exploitation of the forest resource while at the same time protecting and expanding it for the benefit of future generations.
3. To stimulate the active participation of PNG citizens in forestry and associated enterprises.
4. To place strict controls on foreign investment in the timber industry.
5. The State to become a participant in major timber enterprises.
6. To ensure a fair return to landowners, the State and provincial governments from timber enterprises.
7. To ensure that the resource shall be preserved for the benefit of future generations.

I have noted that the existing laws fail to recognize the role of provincial governments and do not advance the principle of decentralisation to the smallest degree. Similarly, the principle of sustained yield or the preservation of the forest resource for future generations is not recognised. Under the forestry legislation the Minister appears to be given an

unfettered power to grant permits entirely as he sees fit and without regard to the principles stated in the Constitution, aimed at preserving the resource. Control of foreign investment and the promotion of Papua New Guinean involvement in the forest industry are not recognised in any of the existing laws.

The need for legislative reform is clear. However, it is of the utmost importance that a comprehensive forestry policy must be formulated prior to any attempts to amend the existing laws. The laws must be firmly based on such a policy and the powers, functions and responsibilities conferred by the laws must reflect every aspect of the policy.

It is only possible to hold a Minister or a Department to account for their decisions or actions, either politically or through legal action, if such decisions or actions can be viewed in the light of approved principles of policy.

The laws specifying the functions of the Department and its departmental head appear to predate the creation of the Minister. It is surely time for this relationship to be clearly analysed and stated in legislation. In its present undefined state it encourages role confusion and allows the Minister to by pass the Department and enables the Departmental Head to almost abdicate his responsibility to put forward forceful and professional advice to his Minister on matters of policy and practice.

## Schedule 1

POWERS AND FUNCTIONS OF THE MINISTER FOR FORESTS UNDER  
THE FORESTRY ACT AND REGULATIONS

FORESTRY ACTSection

3. Minister's powers include those of a Forests Officer and Forests Inspector.
4. Power to appoint a Forest Officer
5. Power to appoint a Forest Inspector
7. Minister may, by notice in the National Gazette, declare any trees or members of any species or class of trees to be reserved trees.
10. Power to grant permits and licenses.
- 12(3) Power to approve the extension of road and bridge construction beyond the permit area.
- 12(6) Power to impose additional covenants, terms and conditions on permits.
- 13 Minister may, by notice in the National Gazette, declare an area to be a special area enabling the grant of a permit for up to 25 years.
- 15 Power to impose additional covenants, terms and conditions on a licence.
- 16 Power to fix royalties payable under permits and licences and power to review the royalties payable.
18. Power to extend the time for removal of forest products not removed.
24. Power to enter and inspect land.
33. Minister may, by notice in the National Gazette, restrict the export of declared species.

(The powers of Forest Officers and Forest Inspectors listed in Schedule 5 may also be exercised by the Minister.)

### FOREST REGULATION

#### Regulation

- 3. Minister may grant or refuse an application or may modify an application with the consent of the applicant. If the applicant does not consent to the modifications then the application fails.
- 4. Power to offer a permit for sale by tender
- 7. Power to fix survey fees.
- 19. Power to establish timber depots.
- 25. Responsibility to receive survey of an intended tramway.
- 26. Power to specify period of construction for an approved tramway.

### Schedule 2

### POWERS AND FUNCTIONS OF THE MINISTER FOR FORESTS UNDER THE FORESTRY (PRIVATE DEALINGS) ACT - Ch - 217

#### Section

- 4. Power to declare a Local Forest Area by notice in the National Gazette.
- 6(1) Power to assent to an agreement for the sale or disposal of timber.
- (6) Power to withdraw assent if conditions are breached.
- 9. Power to approve an assignment of any interest under an agreement for sale.

## Schedule 3

POWERS AND FUNCTIONS OF THE MINISTER FOR FORESTS UNDER  
THE FOREST INDUSTRIES COUNCIL ACT

Section

- 4(2) Minister may, by notice in the National Gazette, appoint members of the Council.
- (3) In respect of members appointed under section 1 (a) the Minister may specify the term of their appointment not exceeding 3 years.
- (4) In respect of members appointed under section 1 (b) the Minister may specify a term for their appointment as he sees fit.
- 5. Power to appoint deputies for each member.
- 6.. Minister may, by notice in the National Gazette, terminate an appointment on grounds that are specified.
- 22 Minister may approve the levy fixed by the Council.

## Schedule 4

POWERS AND FUNCTIONS OF THE DEPARTMENTAL HEAD UNDER THE  
FORESTRY REGULATIONRegulation

2. Responsible for receiving all applications for permits and licences.
8. Responsible for receiving duplicate copies of Log Books with each monthly statement.
9. Responsible for receiving monthly statements, to assess royalties and to deliver assessments of royalties.
13. Responsible for receiving documentation each month from all licence - holders; to assess royalties and deliver assessments of royalties.
14. Power to suspend a permit or licence if royalties are not paid.
15. Power to issue a show cause notice.
20. Power to approve a register book for use at depots.
23. Power to permit a Forest Officer or Forest Inspector to allow a brand to go out of his possession.
24. Power to approve private brands.
30. Responsible for drawing up a working plan for each National Forest.
34. Power to approve creosote derivatives for pest control.
35. Power to require keeping of books of account.
36. Power to issue replacement copy of permit.

Similarly, he constantly interfered with the Ministers' own functions through trickery and by "setting up" the Minister. In this way Minister Diro was forced to approve the entry of the FIC into the field of marketing as Cowan's activities and manipulations made it a fait accompli.

There is also clear evidence of Michael Cowan's interference with both Ministerial and Departmental responsibilities in relation to such matters as the approval of contracts and the consenting to exporting species such as Kwila.

Examples of this interference include:

(a) Allocation of Wawoi Guavi Timber Permit

It is reported in Interim Report No 5 that Cowan's interference in the allocation of a permit for Block 2 to Wawoi Guavi resulted in the final acceptance of permit conditions that were dramatically more favourable to the company than had originally been agreed. At Cowan's instigation, arising from the considerable influence he had over Minister Diro and his close if not criminal association with David Toms of Straits Engineers Contracting Pte Ltd, the Department of Forests was totally by passed in order that Wawoi Guavi would obtain the best possible conditions for its Block 2 Operations. (IR No 5 App.1 p.21).

Cowan's interference with the work of the State's negotiating team is clear. Upon receipt of draft conditions Cowan would actually draft and type up amendments more favourable to Wawoi Guavi.



Finally DOF Secretary Oscar Mamalai withdrew from the scene in total disgust and anger and Cowan and Toms were thereby permitted to wholly distort the negotiating process.

Cowan's lobbying with the Minister also resulted in approval for Wawoi Guavi and SBLC to substantially increase their log exports.

The whole disturbing sequence of events clearly constituted interference with the functions of the Minister and the Department.

(b) Granting of the Vudal TRP to Weco

Cowan's interference with the allocation of the Vudal TRP is extensively dealt with in Interim Report No 3 Volume 1 at page 49.

Acting on Departmental advice Minister Diro stated his intention to issue the permit to Timbersales and not Weco. Upon receiving this advice Graham Ward of Weco enlisted the assistance of his friend Michael Cowan to have the decision reversed.

At Cowan's instigation Minister Diro reversed his decision. It appears that the letters to this effect signed by the Minister were drafted by Graham Ward.

Cowan managed to convince the Minister that the FIC would be an objective third party in the dispute between Weco and Timbersales. Given Cowan's manipulations, such a possibility was complete nonsense. Nevertheless FIC Chairman Miskus Maraleu (who was a paid consultant to

Weco) was delegated authority to decide the issue and, not unexpectedly; found in favour of Weco, which was then granted the permit.

3. Angus and Edward Diro

In Interim Report No 2 at page 53 I made the finding that Minister Diro's motives in directing the allocation of the resource to Angus were for personal gain. The pressure exerted on him by his co-shareholders and most particularly Mr John Kasaipwalova, clearly constituted an interference with the proper and lawful exercise of the Minister's function.

Similarly, Minister Diro's acute conflict of interest in this matter resulted in direct interference by him in relation to the duty of his Secretary, Oscar Mamalai, to properly advise him. The conflict of interest unquestionably led Mr Diro to by-pass departmental advice on some occasions and to ignore it on others.

4. Kabil LFA and John Kasaipwalova

In Interim Report No 4, volume 4A at page 25 the role of John Kasaipwalova in securing Minister Diro's consent for the Kabil LFA is noted. It appears clear that Miskus Maraleu enlisted the aid of Kasaipwalova to secure speedy Ministerial approval and that this assistance was willingly provided.

It appears that the Minister made his decision at the urging of Kasaipwalova even though no application had

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missing

been sent and the copy of the PEC Decision supporting it had also not been despatched. No Certificate of Authority was ever obtained.

This resulted in extensive illegal logging and in the rights of at least seven legitimate landowner clans being totally overlooked.

#### Political intervention:

Many instances have been noted in the interim reports where powerful politicians have exerted almost irresistible pressure on the Minister or Secretary for Forests in an attempt to oblige them to decide an issue in a particular way.

There is a thin dividing line between a Minister or Member legitimately putting strongly the case for his own electorate, or for a person or company operating within his own electorate, and the case of a Minister or Member interfering with the functions of the Minister or Secretary.

For example, both Michael Somare, as Leader of the Opposition and Sir Julius Chan, as Minister for Trade and Industry wrote to Minister Horik voicing their personal concern over the dispute involving Patpatar Enterprises and Dahanamalit Pty Ltd in New Ireland. Correspondence is contained in Schedules 144 and 145 to Interim Report No 4 Volume 4B. Mr Somare stated that he would "personally follow up" an undertaking by the Minister to revoke the permit held by Patpatar Enterprises. Sir Julius expressed his displeasure at the actions of his Ministerial colleague by saying "Frankly, I am disgusted with you".

Schedule 5POWERS AND FUNCTIONS OF FOREST OFFICERS AND FOREST INSPECTORSFORESTRY ACTSection

- 21 (h) Power to give lawful directions.
- 22 (c) Power to require a person to account for how he came into possession of forest produce.
- 24 Power to enter and inspect land.
- 26 (1) Power to seize and sell forest produce on reasonable suspicion of an offence.
- 28 Power to lay informations and conduct proceedings.
- 29 Power to seize and detain unbranded timber
- 30 until royalties and state charges are paid.
- 31 Power to seek a search warrant.

FORESTRY REGULATIONRegulation

- 16 (2) Power to cancel a timber authority.
- 20 Power to permit storage in a government timber depot and to fix maximum quantity to be stored.
- 21&22 Power to use hammer brand or special brands
- 27 Power to authorise use of a tramway.
- 28 Power to suspend use of a tramway and to require repairs.
- 29 Power to require a tramway owner to permit others to use the tramway.
- 31 Power to authorize cutting and removal of power to authorize cutting and removal of undersized timber.
- 33 Power to assess hollow pipe allowance for purpose of royalty calculation.
- 34 Duty to respect logs before export.
- 35 Power to require books of account to be produced.

Schedule 6POWERS AND FUNCTIONS OF FOREST INDUSTRIES COUNCIL UNDER  
THE FOREST INDUSTRIES COUNCIL ACTSection

- |    |   |
|----|---|
| 3  | FIC is a corporation with powers to acquire and dispose of property and to sue and be sued.     |
| 15 | Power to appoint an Executive Officer and other officers and to set their terms and conditions. |
| 17 | Prime function is to promote and develop the forest products industry.                          |
| 18 | Power to delegate its powers.   |
| 19 | Power to appoint agents.  |
| 21 | Power to register forest products operators and to revoke registration.                         |
| 22 | Power to impose a levy on operators.  |
| 23 | Power to allot a distinguishing mark.   |

## 5. INTERFERENCE WITH FUNCTIONS

### Terms of Reference No. 7

"Ascertain whether and to what extent the functions of each of the Minister for Forests, the Department of Forests and the Forests Industries Council under the approved policy for the Forest Industry identified under Term 5 have been interfered with or encroached upon by another or others of such functionaries or any other person".

Once again I am obliged to observe that I have been unable to ascertain the existence of or the terms of an "approved policy for the Forest Industry". As I noted in this report in relation to term of reference No 5 the functions of the Minister, the Department and the FIC are prescribed by laws but are not based on any defined or approved policy.

The wording of this term of reference implies that there may be some widespread and long term encroachment by one functionary upon the functions of another. I make no such finding. While it is clear that interference and encroachment has taken place this has happened on an ad hoc basis rather than as a result of any calculated attempt by any person or organisation to assume or usurp the functions of another. The only matter that comes close to a substantial encroachment would be the involvement of the FIC in marketing but as no other body was authorised or involved in marketing on behalf of the

state it quite clearly cannot be said that this falls within this term of reference.

The following findings have previously been made which, in my opinion, constitute an interference or encroachment as mentioned in this term of reference.

1. Payment of Improper Benefits

While it is clear that the payment of improper benefits to some Ministers and to Oscar Mamalai while Secretary for the Department of Forests led to serious abuses of power it can also be said that such payments constituted interference with the proper and lawful exercise of some functions. One clear example was the payments and other benefits given to Oscar Mamalai by Chin Ah Eng resulting in the improper approval of Gasmata Resources's application for pre-registration.

My findings in relation to New Ireland (Interim Report No 4 Volume 1 at page 67) are another clear indication of this. It is stated:

"My detailed studies of resource allocations and timber operations on New Ireland indicate that bribery, corruption and the buying of support are so widespread that they have become a major social sickness. The speedy decisions on forestry matters by National and Provincial Ministers, Provincial Government members and public servants, without bothering to consult other authorities or to check the facts, and without regard to due legal process, raises serious suspicions that benefits have been given."



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"The situation has been allowed to occur because the Ministry of Forests had no clear policy on allocation and preservation of the resource, because the Department of Forests did not prepare an accurate inventory survey and because some of the timber companies involved made substantial payments to national and provincial politicians, and to political parties, to ensure support for their operations and applications."

The lack of a clear forest policy together with the widespread practice of offering and receiving bribes and inducements has clearly resulted in serious interference with the proper exercise of functions by Ministers, the Departmental Head and his officers. The consequences of this for New Ireland will be catastrophic and permanent.

## 2. FIC and Michael Cowan

In Interim Report No 3 Volume 1 at p 10 I made findings that the activities of Michael Cowan constituted interference with the functions of Minister Diro and Secretary Mamalai.

Mr Cowan clearly managed to gain the confidence of the Minister and accordingly the proper functions of the Departmental Head were interfered with and encroached upon to a significant degree.

More recently Minister Stack acknowledged that he was under considerable pressure from Michael Somare to declare the Lower Sepik LFA and he acknowledged that he did not see himself as being in a position to deny the wishes of his Ministerial colleague.

Whether such intervention by another Minister in forestry matters amounts to interference or "encroachment" would need to be considered in the circumstances of each case. Obviously an intervening Minister needs to exercise restraint especially if he has some personal interest in the desired result.

(There are no pages numbered 260 to 266 inclusive. The next page is page 267)

## 6 MARKETING AND TRANSFER/PRICINGS

Term of Reference No. 9

Ascertain whether any and if so which person or persons associated with the PNG timber industry have been frustrating government policy by misdescribing species, quantity or value of log exports or by deliberately understating income or overstating costs or by manipulating shipping freight charges or by any other similar devices including the practices commonly referred to as transfer pricing.

### Outline of Marketing Investigation:

To investigate the question of transfer pricing and other devices used for making improper and secret tax free profits involved the Commission in a major investigation which has continued throughout the life of the inquiry.

I have defined transfer pricing or profit shifting widely to cover the various practices whereby goods or services are imported at a falsely high price above their true value and whereby goods and services are exported at a declared price below their true value. In each case the difference between declared value and true value is transferred or shifted to an outside country. Often but not always the chosen country is a tax haven but transfer pricing sometimes occurs for other corporate reasons - not always in order to gain a taxation benefit.

The sorts of practices which were investigated discovered and described include;

- (a) transfer pricing through third country invoicing, back to back and parallel letters of credit
- (b) inflating the costs of imports of goods and services
- (c) undergrading, undermeasuring and misdescribing species and thereby disclosing a falsely low export price
- (d) often the price is fixed at MEP or in a fixed relationship to MEP. (eg USD per m3 above MEP.)

All these export price devices are in the result aimed at disclosing a falsely low sales price in PNG so as to take extra profit off-shore. It means that the PNG exporting company's profit is reduced for tax purposes and the export duty is reduced as it is calculated on the falsely low PNG FOB price.

My investigations into marketing commenced with the Angus Inquiry which disclosed the inner documented details of two types of transfer pricing. This was followed up by some preliminary on the spot inquiries into New Ireland companies. I discovered that transfer pricing seemed to be widespread and then embarked on a nationwide investigation. This was done by sending a questionnaire to all timber companies involved in conducting a timber operation and/or marketing logs. The questionnaire is attached to Interim Report No. 6. As well as seeking answers about marketing and such things

as agency commission arrangements it requested the presentation of a schedule of shipments and prices for the years 1986 and 1987 and comparisons with MEP prices.

After analysing the answers and comparing them against DOF records and other information in my possession I decided to hold public hearings at Waigani into a number of companies. Counsel assisting did a great deal of preparation work for these hearings so that he was in a position to pursue relevant lines of inquiry and to conduct an effective cross-examination. The companies whose marketing practices were investigated by the Commission were as set out in the following table:

**COMPANIES INVESTIGATED  
FOR MARKETING MALPRACTICES**

MARKETER/PRODUCER	INTERIM REPORT (IR)
STETTIN BAY LUMBER CO	1R. 6 App.5
VANIMO FOREST PRODUCTS	1R. 5 App.2
WAWOI GUAVI TIMBER	1R. 5 App.1
OPEN BAY TIMBER	1R. 6 App.6
TONOLEI DEV. CORP.	1R. 6 App.9
BISMARCK INDUSTRIES	1R. 6 App.7
GAISHO (TASUKOLAK, CENTRAL POMIO LOGGING MENVUVU, UGANA TIMBER, DJAUL DEVELOPMENT, GAULIM LOGGING, DANFU LOGGING, AND NEW IRELAND INDUSTRIES)	1R. 4 App.6
LUSCO (LEYTRAC, WOODLARK IS. DEV., ULAMONA MISSION, AND MENVUVU)	1R. 4 App.5 (LEYTRAC)
SHIN ASAHIGAWA (UNEVULG, CENTRAL POMIO LOGGING, GAULIM LOGGING, CHANNEL TIMBERS, ITSELF)	1R. 6 App.8
	1R. 6 App.1
SUMITOMO FORESTRY (TONOLEI DEV, CENTRAL POMIO LOGGING, KUMUSI TIMBER, ULABO TIMBER BOUGAINVILLE F.E. & ANG TIMBERS	1R. 6 App.1
UNITED TIMBER	1R. 5 App.3 (KUMUSI)
SANTA INVESTMENTS (AHIA DEV. AND SOPATHIN DEV)	1R. 4 App.4
BRUCE TSANG (BROTHERS LOGGING NOATSI LOGGING AND NAKMAI CO)	1R. 4 App.3
	1R. 4 App.7

ANGUS PNG	1R. 2
TIMBERSALES (CENTRAL POMIO LOGGING AND GAULIM LOGGING)	1R. 6 App.4
NAM YANG TIMBERS	1R. 6 App.3
MALAYSIA OVERSEAS INVESTMENT	1R. 4 App.1
DEWAI RESOURCES	IR. 6 Sch.9

No study was made of WECO, and WEWAK TIMBERS (including ULINGAN DEVELOPMENT). The answers to questionnaire and marketing tables for WEWAK TIMBERS are included as Appendix 10 to Interim Report No. 6.

The main report on marketing, the discussion of the practices and principles involved and the presentation of the shipment by shipment and other statistics is set out in IR No. 6.

#### General Findings on Marketing

In answer to Term of Reference No. 9 my general findings are that almost all companies involved in marketing PNG round logs are engaged in some form of transfer pricing and/or other serious marketing malpractice. The only exceptions I found were: Vanimo Forests Products Pty Ltd and (possibly) Tonolei Development Corporation has been "clear" since 1986.

In presenting this report I have taken a wide view of "marketing" and have considered all malpractices commencing with the initial preparation, measurement and marking of the log to the sale and loading of the log, the preparation of letters of credit and "transferred back to back" and "parallel" letters of credit, to the unloading and remeasurement of the log in the country of destination, the "marked up" payment by the end buyer in Korea or wherever or the safe delivery of the log to the parent company in Japan at a low, subsidised price. I have traced the money as it flows from the end buyer (by way of bank letter of credit) to the Hongkong (or other) intermediary company where the tax free off-shore

component drops off. I have traced the disclosed onshore component which flows to PNG as the disclosed FOB price and I followed the flow of that FOB price and examined the distribution or "split" between foreign logging and marketing company and the landowner company (if any). I noted that the preparation of financial documents, is invariably done by the foreign marketing company and that the PNG bound letters of credit are invariably received by that company's PNG banker (which in most cases would require this as a form of security for money already advanced). The way the foreign marketing companies divide the PNG disclosed FOB price between itself and the landowner company (if any) has been studied. How the landowner company pays royalties and deducts its own expenses (such as management salaries and directors expenses) has been noted. When all these deductions have been taken from the landowner company's share of FOB price there is rarely a profit left for distribution as dividends or in the form of other benefits to its shareholders.

At every point in this movement of logs (and shipping documents) from stump to overseas end-buyer, going in one outwards direction, and in the flow of money in the form of financial documents coming back (usually indirectly through an intermediary third country) to PNG, malpractices are occurring. The effect of the various malpractices is to lower the disclosed FOB price in PNG and therefore to lower export duty paid and company tax paid to government and to lower the price received by landowner company and the share distributed to landowners. The difference between disclosed PNG (or domestic) FOB price and end buyer price is held overseas for the benefit of the PNG marketing company or for its parent company or the company group to which it belongs.

Some of that overseas fund is used to make political contributions to politicians bureaucrats and landowners who can assist the company.

Malpractices such as undermeasuring or undergrading the log reduce its disclosed value and reduce the MEP applicable to it. Fixing the price at MEP (or in relation to MEP) also reduces its disclosed value; switching letters of credit, inflating the cost of imported goods and overseas management or consultancy fees all have the same long term affect of reducing the profit shown in PNG for tax purposes. All are dealt with in Interim Report No. 6.

Cheating by the foreign timber company when accounting to the landowner company on its shares of the falsely low FOB price will not affect export duty but it will affect price finally received by the resource owners and so that malpractice is also dealt with in Interim Report No. 6 as an aspect of marketing.

Finally Interim Report No. 6 also traces the various forms of government control which are designed to detect and stop malpractices in the bush, at the loading point in the "third country transfer pricing companies", in the Japanese parent companies or the PNG company's shipping department and accounts section. Malpractices are occurring at each point and inadequate government controls have been imposed and they are not been administered effectively.

Some brief details of transfer pricing and other malpractices carried out by individual companies are set out in section 8 as they amounted to improper benefits received. Further details and complete descriptions are set out in Interim Report No. 6 or the other reports.



For my formal report on Term of Reference No. 9 I reproduce extracts from the Commission's findings which are already set out in IR. No. 6.

### TRANSFER PRICING AND RELATED ABUSES

#### Definition:

Defining "transfer pricing" or "profit shifting" is quite a simple task. It covers the various practices whereby:

- (a) goods or services are imported into a country for a declared price which is in excess of their true value; and
- (b) goods or services are exported from a country for a declared price which is less than their true value.

Whilst the differential between true value and declared price is often reposed in a country where tax treatment of that differential is favourable I do not consider that to be a necessary element. There may be a multiplicity of reasons why a corporate group would be prepared to.

### OVERVALUING IMPORTS

As stated earlier the Commission's attention was not directed, in the main, at such abuses though instances were detected incidentally. The subject is discussed earlier in Section 3 pp. 85 - 86 and in IR No. 6. Under "Control Systems - Import Controls". Details of matters detected or requiring further investigation are:

Stettin Bay Lumber Co: (IR No 6 App.5)

Documents supplied show that this company:-

- (a) in the past paid technical assistance fees for reafforestation to Nissho Iwai (Japan), Nissan and C. Itoh and Co. (IR No 6 App.5 Sched 8).
- (b) in 1987 recorded technical assistance fees of K120,358 in relation to sawmilling (IR No 6 App.5 Sched.7).
- (c) in its 1987 forest management recorded technical assistance fees of K65,879. (IR6 Aff 5 Sched 15)

These fees should be investigated to ascertain whether true value was received. The Commission did not undertake any investigation.

Vanimo Forest Products: (IR No 5 App.2).

This company has the right, under its Project Agreement, to retain funds offshore to meet foreign currency payment obligations, for the supply of goods and services. Payment is to be justified and Central Bank approval obtained.

The Commission did not investigate what payments, if any, have been made and what proof has been presented. These payments should be investigated to ensure full value was obtained.

Wawoi Guavi Timber Co: (IR No 5 App. 1)

The Commission's investigations of this company were impeded by pending Court proceedings, which have now concluded. It was established that, after Inchcape Group took over marketing, Straits Engineers Contracting Pty Ltd. received an unearned marketing commission of 2% of FOB value (in addition to the commission of 4% of FOB value paid to Inchcape Group). This payment amounts to transfer pricing.

The arrangements over barging fees, equipment imports, equipment leasing or hire to subcontractors, and overseas salary payments to expatriate workers all require investigation. This investigation could not be undertaken by the Commission as it was the subject of allegations and counter allegations in the then pending Court proceedings.

In the marketing of Inchcape Group, evidence was found of clear freight manipulation amounting to transfer pricing on two shipments. This also requires further investigation.

Shin Asahigawa: (IR No 6 App.1).

This company paid a related company in Japan a management fee of 48 million yen (K306,000 in 1987) per year for what seem essentially to be non existent services. The bulk of the fee was paid as additional (undisclosed) salaries and bonuses to its PNG expatriate staff. Group tax was levied on these salaries and bonuses, when detected. This amounts in large part to transfer pricing.

Santa Investments: (IR No 4 App.3)

This company also made overseas salary payments to expatriate staff. Any overseas payment made by this company would require thorough investigation as to the value received for it.

Angus (PNG): (IR No 2)

It was established by documentary evidence that this company smuggled liquor into PNG and was involved in the import of a Jaguar motor vehicle at an undervalue.

Malaysia Overseas Investment: (IR No 4 App.1)

Documentary evidence was obtained of Francis Sia seeking a false invoice covering spare parts to avoid payment of the proper import duties.

Madang Timbers: (IR No 7)

Information recently received (but not verified) by the Commission suggests that equipment imports by this company should be investigated.

As I have said the above matters have come to light incidentally. The import control and evaluation systems in place are such that there is no effective control preventing overpricing of imports of goods and services by the timber industry, particularly in technical areas such as management and consultancy fees and "know how" agreements. There is every reason to believe, in the absence of an effective control system, that abuses are widespread and that losses in foreign currency earnings

and revenue are occurring on a fairly large scale. I cannot even guess at the magnitude of such losses but urgent remedial action is required.

#### UNDERVALUING EXPORTS

This is the area where the main attention of the Commission was directed - particularly at log exports. It has required the Commission to develop and refine its own investigation techniques and these are reported in IR No. 6.

The paths which a shipment of logs takes, and which the money paid for those logs takes, are both reasonably easily established from documents within PNG. The price which is declared for a shipment of logs is again easily established from documents within PNG. What has been difficult to establish is the price paid by the "true" destination buyer of that shipment.

The Commission was able, through FIC, DOF and other informants, to obtain some destination end invoices for some shipments from various producers. From that starting point it was possible to force further disclosures which have given an insight into what is occurring and to establish a base of information from which it could be reasonably accurately stated what other producers and marketers have been and are doing.

The process by which this has been done and the result of what was discovered is set out in appropriate detail in the various Interim Reports and Appendices listed at page 3 and in IR No. 6.

It suffices for the present to say export transfer pricing on log sales has been widespread and rife for many years and that there are indications it is continuing and that it will probably continue in the future.

- (a) undermeasurement is a significant abuse but probably not widespread on a significant scale.

The statistics in the Goodwood report for 1981 to 1985 indicate undermeasurement in the order of 3% to 6%.

There is clear evidence detailed in IR No 6 undermeasuring by Santa Investments, United Timbers and Tonolei Development Corporation.

There are indications, which the Commission has not had time to investigate, that two other companies, which in fairness I shall not name, have engaged in undermeasuring (smuggling).

- (b) species misidentification is a significant abuse and probably widespread.

The abuse is not easy to detect unless seen "on the spot". It would be detected by a skilled forester conversant with written Japanese and English comparing PNG species classifications and Japanese species classifications on a shipment by shipment basis. I have seen sufficient examples on field inspections to convince me that my finding is both justified and accurate.

- (c) undergrading is a significant abuse and is

reasonably widespread.

There is clear evidence, detailed in IR No 6, of undergrading by United Timbers, Open Bay Timbers, Bismark Industries and Sumitomo Forestry Company.

All these abuses occurring in isolation have the effect of producing a falsely low MEP price for log shipments and where they occur in combination of multiplying that effect. They thus increase the scope for, and potential amount available for, transfer pricing.

Undermeasurement also reduces the royalties payable as does species misidentification where a log of a higher royalty rate species is classified as a log of a lower royalty rate species. Bruce Tsang was found to be paying lower non premium royalty rates on all logs harvested, he thus cheated on royalty payments without having to misidentify species.

I have found that transfer pricing is a widespread and almost general practice in the timber industry in Papua New Guinea - if it is not the producer it is his marketer and if it is not the producer or marketer it is the marketer's corporate group which benefits. It is always Papua New Guinea which loses. I accept that there are some honest log sellers but that seems to be the exception rather than the rule.

On the evidence this Commission has uncovered, I estimate that transfer pricing on log sales during 1986 and 1987 averaged about USD5.00 to USD10.00 per m3 with a mean of about USD7.50 per m3.

I thus estimate losses in foreign currency earnings:-

(a) in 1986 when 1,313,800 m3 of logs were exported at within the range of USD6.6 million to USD13.1 million - probably in the order of about USD9.85 million.

(b) in 1987 when 1,442,200 m3 of logs were exported at within the range of USD7.2 million to USD14.4 million - probably in the order of about USD10.8 million.

I am not able to estimate the amount of royalty revenue lost as I do not have sufficient evidence to even make a guess.

It follows from my earlier estimates (as the export duty rate is 10% of FOB value) that if export duty had been correctly calculated in 1986 and 1987 (as it was not until June 1987) the revenue loss in export duty arising from transfer pricing would have been about USD985,000 in 1986 and USD1,080,000 in 1987.

For reasons outlined in IR No. 6 Vol 1 p. 234 I have estimated that about 70% of lost foreign exchange earnings in 1986 and 1987 will be taxable at company tax rates of 30%. It can thus be estimated that additional tax that would otherwise have been lost will be in the order of USD 2 million for 1986 and USD 2.27 million for 1987.

In summary then I consider that in 1986 and 1987 the annual loss in foreign currency earnings was in the order of USD10 million and in revenue from export duty and company tax would (but for some subsequent recovery) have



been in the order of USD3 million annually. There would be additional revenue losses on royalties. I would add that current tax investigations are likely to result in recovery of significant amounts of tax relating to years prior to 1986.

At this stage, from the information obtained and investigations undertaken as a result of the commission's work-:

- (a) 13 companies have agreed to pay K3,088, 163 in company tax and penalties
- (b) 4 individuals have agreed to pay K74,031 in income tax and penalties
- (c) 4 companies have agreed to pay K747,568 in group tax and penalties
- (d) revised company tax assessments of K3, 968,008 against 4 companies have been issued and are under dispute
- (e) revised income tax assessments of K2,191,592 against 4 individuals have been issued and are under dispute
- (f) 8 companies are under active investigation to finalise tax reassessments.

As I have said earlier the Commission's detailed reports on each company investigated or examined in relation to Marketing are listed by reference to Interim Report and Appendix number set out at page 3 above. I now briefly and thus inadequately state my findings on transfer pricing by way of underpricing timber product exports:-

Stettin Bay Lumber Co.: (IR6 App.5)

Sold on an exclusive non competitive basis to its sister company Nissho Iwai Hong Kong (NIHK). NIHK resold to non Japanese buyers and one Japanese buyer from Hong Kong at a profit. NIHK also sold to the parent company Nissho Iwai Corporation (NIC) at close to cost price and paid NIC its profit on direct sales to the Japanese buyer - NIHK received 1% commission on Japanese sales. NIC resold to other Japanese buyers. There was clear transfer pricing of over USD 3 million between 1985 and 1987 and indications of large scale transfer pricing before 1985. Sawn timber was sold through the related company Nissho Iwai (Australia) (NIA) for a commission. NIA resold to Australian and New Zealand buyers and its markup on two shipments may amount to transfer pricing.

Vanimo Forestry Products: (IR5 App.2)

Sold to buyers, usually direct, through its exclusive sales agent Quarter Enterprises which received a high (3 1/2%) commission plus an extra USD1.00 per m3 on Korean sales. It is one of the exceptions where there was no evidence of transfer pricing but the Commission's investigations were not sufficient to establish this conclusively.

Wawoi Guavi Timber Co: (IR5 App.1)

Pending Court proceedings precluded thorough investigation. Freight manipulations (amounting to transfer pricing) were established when a member of the Inchcape Group was marketing. Excessive unearned marketing commission paid to its Singapore

parent Straits Engineers Contracting amounted to transfer pricing.

There is every reason to believe this company was transfer pricing on a significant scale by various devices. The Commission could not establish this conclusively because of the Court proceedings. Further investigation is warranted now that the Court proceedings are ended.

Open Bay Timber Co: (IR6 App.6)

Sold on an exclusive non competitive basis to its parent company - initially Sobu Tsusho and then Kowa Lumber which both resold at a profit.

Found to have undergraded on a large systematic scale. Its massive onshore losses, supportive finance from its parent company and price and grading patterns clearly indicate systematic transfer pricing on a large scale.

Tonolei Development Corp: (IR6 App.9).

A genuine landowner company which was not thoroughly investigated as it was in the midst of delicate negotiations to buy out its foreign contractor.

Was engaged in freight manipulations and established undermeasuring in and prior to 1986 on some shipments. Since that time it also appears to be operating as one of the exceptions and not transfer pricing but time has not permitted sufficient investigation to establish that conclusively.

Bismark Industries: (IR No 6 Ap..7)

Sold on an exclusive non-competitive basis to a related company Nippi Overseas Development through two related Hong Kong intermediaries. Nippi Overseas Development resold to other buyers. Its principal James Shindo avoided appearing before the Commission. The 5% commission paid to a Hong Kong intermediary was not earned and amounts to transfer pricing. Found to have undergraded on a significant scale. Its market structure and price and grading patterns clearly indicate systematic transfer pricing.

Gaisho Company (NG): (IR No 4 App.6).

Sales are made on an exclusive basis through its parent gaisho Co (Japan). Documentary evidence of cheating local companies and transfer pricing on non Japanese sales through its parent company from 1985 to 1987. Sold to its Japanese buyers and parent Company (for resale) at an undervalue.

Found to have transfer priced on a large scale over many years with the amount likely to have exceeded K6 million.

Lusco Enterprises: (IR4 App.5 and IR6 App.8)

Sales made through a related company Holdcrown in Hong Kong and May Shan Trading Inc. Its principal Rex Grattidge avoided appearing before the Commission. There is documented evidence of systematic transfer pricing.

Shin Asahigawa: (IR No 6 App.1)

Sales made through a sequence of Hong Kong intermediaries to a Korean buyer and (through a related Japanese company Sanko) direct to a number of Japanese buyers.

Documented evidence of large scale systematic transfer pricing on non Japanese sales and of understated prices on Japanese sales. Transfer pricing estimated between 1981 and 1987 at over K6 million and accepted at K4 million for which tax liability of K1.7 million has been accepted. False management fees applied largely in offshore salary payments to expatriate employees (which were undisclosed) were discovered and led to accepted Group Tax liability of K200,000.

Sumitomo Forest Co:(IR6 App.2 IR5 App.3 IR6 Sched 9)

This company is a buyer of logs for resale with a small physical presence in PNG. It is carefully structured to avoid PNG tax liability on its resale profits. Found to have deliberately and systematically undergraded. It has exclusive arrangements with some producers and financial arrangements with producers or their managers are strongly suspected - this would bear further investigation. Very substantial markups on some resales and the fact and size of resale profits is probably indicated by the fact that Sumitomo finds it worthwhile to maintain a physical presence in PNG.

United Timber (PNG): (IR4 App.4)

Sold on an exclusive uncompetitive basis to its financier Mitsubishi Corporation with which it had a long prior history of association in Indonesia where it was a systematic transfer pricer.

Found to have under graded on a large systematic scale reducing its MEP levels (falsely) by in the order of USD 300,000 in 1986. It also undermeasured significantly. Admitted transfer pricing through Hong Kong and later underpricing for Mitsubishi Corporation's benefit. The return for that underpricing was financial support.

Transfer priced USD1.5 million in less than two years and admitted and paid tax on transfer pricing of K1.1 million in that period.

Santa Investments: (IR4 App.3, IR7)

Sold on an exclusive uncompetitive basis to its related company Hindai Timbers (Singapore) which resold at a profit. Then sold on an exclusive non competitive basis to Sumitomo Forestry Company (suggesting financial links). Its principals Michael and Francis Sia are committed for criminal trial on documented charges alleging massive undermeasuring. Documented proof of large scale transfer pricing through Hindai Timbers in 1986 estimated to amount to K1,235,000. Has accepted transfer pricing allegations and not disputed reduction of its tax losses.

Has also evaded group tax of about K250,000 on overseas payments to expatriate employees which it

has, after detection, been obliged to pay.

Bruce Tsang: (IR No 4 App.7)

Tsang used two companies - Sakai Management and Nationnwide Consultants. His appalling record of onshore cheating was supplemented by transfer pricing through Hong Kong, which he admitted. I estimate that he have transfer priced up to USD450,000.00 in 1986 and 1987 - he admitted much less.

Malaysia Overseas Investment (PNG): (IR No 4. App.1)

I have altered the order slightly as it is fitting that this company of Francis Sia (formerly of Santa Investments) stands alongside Bruce Tsang. His appalling record of onshore cheating was also supplemented by a continuation of the efforts to transfer price as he had engaged in with Santa Investments.

There is documentary evidence of attempts and plans to transfer price and of deliberate attempts to avoid imports duty by obtaining false invoices for import of spare parts.

Angus PNG: (IR No 2)

Sales were arranged through affiliates in Singapore and Hong Kong before FIC took over and the company failed. There is documented evidence of transfer pricing on first two shipments and of liquor smuggling.

On documented evidence I found that a grandiose plan

to transfer price USD 9.4 million through company structures was being put in place with Minister for Forest E.R. Diro standing to receive 35% of proceeds. Failure of the company intervened.

Nam Yang Timbers: (IR No 6 App.3)

Sold to buyers through the one Hong Kong intermediary company at essentially MEP prices. This structure and price patterns clearly indicate transfer pricing on a large and systematic scale. This company merits further investigation as large volumes of log exports were involved.

Madang (Wewak) Timbers: (IR6 App.10) (IR7)

Time has not permitted a study of this company's marketing. On information received and partial investigation to date, its marketing during the time of its ownership by Gasmata Resources should be investigated.

Dewai Resources: (IR No 6 App.9).

Would have sold its first shipment for Binedere Holdings at a substantial undervalue to Sumitomo Forestry Co. but for DOF intervention. The explanation is that the company is a new inexperienced, incompetent marketer rather than that it was transfer pricing.

Superior Tropical Timbers: (IR No 7)

This company's Australian "partner" advised a prospective sub contractor for the proposed Rai Coast TRP area that transfer pricing, suggested at



USD15 per m3 or USD1.5 million per year, would be "uninhibited".

This is the brief catalogue of what was found on log marketing (and sawn timber). Other companies which have operated since 1986 such as Goodwood and Luabar Logging to name but two (on which some information was received) should be investigated in relation to marketing. The Commission has not had the time or staff to do this.

#### Woodchip:

On woodchip marketing by Jant the Commission expended time and effort to obtain evidence or information to make a study. The DOF has little helpful market knowledge and no comparative data available for tropical mixed hardwood chips (but only for eucalyptus chips). The task was abandoned in frustration. The Goodwood report indicates transfer pricing can probably be inferred from the uncompetitive exclusive sales arrangement between Jant and its parent Honshu Paper and the fact that Jant has continued to operate for so long without making a profit. Other commentators have made similar comments. This may well be a correct view by I can make no report as I have no proper evidence on which to make a judgement.

#### Sawn timber:

On other processed timber products (including sawn timber) there are no effective price controls at all and the opportunity to transfer price in the result is almost uninhibited. Controls will be needed if exports are revived.

#### Rattan cane:

Again the controls on export pricing of rattan cane are hopelessly inadequate and guidelines prices are fixed low and without any real knowledge of obtainable market prices. There is ample opportunity to transfer price and the chaotic rush to export, poor returns to landowners and spate of Court cases over rattan cane suggest transfer pricing is occurring.

#### Sandalwood:

DOF has assured the Commission that on the small exports of sandalwood there is adequate knowledge of market price and that there is little scope for transfer pricing. This has not been investigated or verified.

#### Balsa

The marketing of balsa, which is only permitted in a processed form, came to my notice late in the life of the Commission. Present levels of export are low and the industry appears to be subjected to quite tight monopolistic control. This is a potentially important area for PNG particularly as balsa is said to have only a seven year growing period. The Commission has received information which indicates that there may be massive abuses in balsa marketing and that urgent and thorough investigation is warranted.

#### CONCLUDING COMMENTS

I can do no better than to reproduce my comments at pages 243 - 245, Interim Report No.6 Vol.1.

"It has been a sad task compiling this Interim Report which I am sure will infuriate most thinking Papua

New Guineans and which I hope will spur Government to prompt remedial action in the National interest.

The report is deliberately long and comprehensive in the hope that this will assist in formulating an appropriate remedial programme.

It is a fundamental rule of business that an enterprise will maximise its own interests and benefits to the extent it is permitted to do so by Government.

There is thus an obligation on Government to control and constrain such an enterprise in the national interest and in the interests of its people if an equitable balance is to be found. This is particularly so when the enterprise is exploiting natural resources. The timber industry has (in general and with some exceptions) maximised its interests and benefits from the exploitation of the timber resources of this country.

Government has done very little to control or constrain the timber industry, a balance of equity has not been achieved and the national interests of the people have been compromised as a consequence.

The deficiencies and inadequacies in the control and constraint systems and in their implementation have been well known for a long time. They have been reported upon for the last ten years yet little has been done to remedy these problems until recent times and those recent efforts are now showing signs of strain.

As a result the country has lost vast sums in:

- (a) foreign currency earnings
- (b) royalty payments

- (c) export duty
- (d) income (company) tax

The people have lost by not receiving an equitable share of the monetary gains from the exploitation of their timber resource in terms both of royalty payments and shares of profit because falsely low prices have been disclosed and accepted. The real "profits" have been reposed offshore mostly in countries where they receive preferential tax treatment.

2 This again has been well known and well reported upon for the last ten years yet little has been done to remedy the position.

I hope that this interim report will show the national leaders the utmost seriousness of this disgraceful situation. It can be resolved only if nation political and public service leaders accept their responsibility to the national and its people and act purposely and decisively to curb abuses and price manipulations in the timber industry. Clear policies must be formulated and effective controls must be put in place to ensure active supervision in the industry from felling to final price. The legislation must be revised and the public service must be reorganised and revitalised. The State must intervene in marketing and throughout this process the people and the forests must be protected.

The Commission and its staff have gained much experience and many insights from this long inquiry. This interim report endeavours, not only to make a factual report, but to pass on the benefit of that experience and those insights.

I pray that it will be acted upon and not be left gathering dust on the shelf with the previous excellent reports to which I have referred".

7. FOREST INDUSTRIES COUNCIL AS THE STATE MARKETING  
AGENCY

This section formally reports upon Terms of Reference 1,2 and 7 which all state questions relating to the Forest Industries Council operations as the State Marketing Agent.

The full report on the FIC was presented as Interim Report No 3 (in four volumes). I now propose to repeat the findings set out in Section 5 of Volume 1 of that interim report at pages 167-180. For a full discussion of those findings it will be necessary to refer to Interim Report No.3.

Term of Reference No 1

"The process by which the Forest Industries Council became involved in the marketing of timber"

"(a) when and by whom, a decision was or decisions were made to involve the Council in marketing operations".

Briefly, in May 1979 the NEC decided in principle that there should be some form of State Marketing Authority to:

*"promote the use of PNG's lesser known species, diversify markets and sell directly to end users rather than through intermediaries."*

In the appendices to the submission the NEC was considering, there was a repeated assumption that the SMA should be the FIC. This idea was rejected by the NEC which directed that all mention of FIC doing marketing should be deleted. During the next six to seven years the bureaucracy argued the question ineffectually until it finally settled on the idea of giving the job to an international marketing agent to be selected by tender. This galvanised the FIC to lobby strenuously to be appointed as the SMA and then in August 1985, a submission was put before the NEC recommending that appointment.

The very real objections to FIC performing this role, the fact that the FIC did not have the statutory authority to do the job and the fact that six years before it had already been rejected by the NEC as an appropriate SMA were not put before the Minister or the NEC by the DOF when the August 1985 submission was being considered.

The NEC, by decision No 220/85, approved in principle that the FIC should perform the role of the SMA but directed that a series of steps should be carried out first, after which a formal agreement between the FIC and the State should be prepared in draft and referred to the NEC for final approval. In this way it was hoped that proper structural changes would be carried out in the FIC organisation to make it an effective body for its proposed new role. Recruitment of expert staff and the creation of an independent marketing section within FIC, with its own records and accounts, were envisaged. Guidelines for FIC's marketing arrangements were to be formulated for NEC approval.

In early 1986 however Miskus Maraleu became acting Chairman and Michael Cowan became Executive Director of FIC. They ignored the NEC decision and commenced marketing without formal approval or legal authority and without referring the matter to the Council of the FIC. The new Minister for Forests Mr E.R. Diro, was faced with a fait accompli. Cowan and Maraleu convinced him of FIC's assured success in its new venture and persuaded him to give it his unqualified support and authority. This he did, apparently unaware that he did not himself have the legal authority to direct or authorise FIC in this marketing venture. He does not appear to have been briefed at all on the subject by DOF Secretary Mamalai until much later; certainly not by written memo retained on DOF files.



Thus the way was prepared for FIC involvement by NEC decisions NO.72 of 1979 and No 220 of 1985. The decision to start the actual operation was taken by Cowan/Maraleu in August 1986 when the first shipment to India was put together. The formal agreement between FIC and the State, which was intended to be a prerequisite before the commencement of operations was drawn up in draft and approved by FIC in January 1987. An NEC Submission was prepared but was never formally approved by NEC nor signed on behalf of the State.

*"(b) The nature and extent of the operations".*

There were 15 shipments over the six to seven month period between October 1986 and March 1987 containing a total volume of 102,916.639 m<sup>3</sup> of logs. They were purchased by FIC from fourteen producers in nine provinces and sold by FIC to thirteen buyers in India, Taiwan, Japan and Korea.

FIC mostly bought from producers on an FOB basis and sold to buyers CNF (there were four exceptions). Its main log supply from most producers came from exercising the State's right to purchase 25 percent of their export logs but it also sold logs volunteered by some producers, notably Wawoi Guavi Timber Co. Pty. Ltd. and Angus (PNG) Pty. Ltd. for which companies FIC became sole marketing agent for a period.

The effect of FIC's operations extended beyond those 15 shipments because there were many instances where overseas buyers were forced to raise their prices to outbid the prices which FIC was able to offer. Also the mere fact of FIC competing on the Korean market, through its sole agent S.J.Park, forced the price of logs up on both the Korean and the Japanese markets.

That is the quantitative aspect of the nature of FIC's operations. Qualitatively, it must be said that its operations, under the leadership of Cowan and Maraleu, were inefficient, to the point sometimes of being chaotic; were secretive and "sharp", to the point of being dishonest; and were counter productive, in terms of many of the aims set down for FIC as the SMA. Cowan arranged FIC's trading so that secret margins, commissions, price mark ups and false freight rates became a matter of routine. PNG producers were denied the access to accurate market information which it was part of FIC's role to give and they were denied their full, rightfull share of the profits from the sale of their products. Cowan and FIC built up a large balance in an unauthorised US Dollar bank account, part of which Cowan misappropriated and part of which he misused in other ways. (The balance of the USD account was used to pay legitimate overseas charges).

The marketing operations of the FIC stopped in February/March 1987 amidst public controversy and scandal.

The most important benefits from FIC's marketing activities were the creation of an element of competition in the international log markets for PNG logs with a consequent rise in log prices and the generation of market intelligence which enabled PNG authorities to make more accurate assessments of the true market value of PNG logs and to fix more realistic Minimum Export Prices.

"(c). the nature and extent of any Ministerial involvement in marketing operations.

Ministers Aoae and Waka were involved as part of their normal ministerial functions in the extended decision making process which culminated in the 1985 NEC decision authorising FIC to formulate its proposal for being appointed as the SMA.

Minister Diro was involved in retrospectively "validating" and purporting to "authorise" the operations which had already commenced. Later he was involved in publicly supporting and encouraging FIC Marketing in speeches to the National Parliament in meetings and to the press; and so later, was Minister Torato.

Prime Minister Wingti's involvement was to stop FIC marketing and to set up this Commission of Inquiry. (He had not been informed of DOF's role as the replacement SMA)

I have found only three occasions in which any Minister publicly became involved in actual marketing. They were:

- (i) In September 1986 when Mr. Diro wrote to Vanimo Forest Products urging them to make Kwila available for sale by the FIC. This letter was drafted for him by Michael Cowan and he signed it at a time when he was becoming indebted to Cowan over a free trip and spending money Cowan arranged for him.
- (ii) In October 1986 when Mr Diro sent a fax to Tonolei Development Corporation designed to encourage it to accept a price offered by FIC.
- (iii) In September 1986 when Mr Diro publicly involved himself in the signing of the long term contract with Sanko. By so doing he may have altered the situation regarding possible liability of the State for breach of contract.

There is no evidence that any Minister received any direct benefit from the proceeds of log sales.

"(d) the role (if any) played by the Department of Forests in the actual marketing operations....."

While FIC was acting as the SMA the DOF performed very useful support functions. In the early days it sought and received State Purchase Options offers from producers which it then passed on to the FIC to process. In later days it used its authority to follow up on companies which refused FIC offers on the ground that their own buyer was offering a better price. Using its power to recommend the refusal of an export licence DOF ensured that those companies did sell at or above the offered FIC price. In the concluding days of the FIC operation DOF was developing considerable expertise in assessing the true market value of log shipments and it began to refuse to recommend export licences unless it was satisfied that the price was at true market level (regardless of MEP).

After FIC ceased marketing DOF set itself up in a SMA role, but acted only as an agent. It had considerable effect in maintaining and raising prices with less risk, cost and effort than was involved in the FIC operations.

"(e) the financial effect of the marketing operation on the funds of the Council.

The financial effect can be stated very briefly. Far from the net profit of K36,329 it claimed to have made, the difficult and detailed study by this Commission of Inquiry, (supported in so far as they went by the Auditor General's study and that of Messrs Cooper and Lybrand) show that the FIC, during the period of its operations as SMA, made an operating loss in excess of USD40,000. In addition it faces contingent liabilities in excess of K500,000. The details behind these figures are set out in Section 3 and the supporting appendices to this Report. The operating loss was caused by Cowan's decision to actually trade as a buyer and seller of logs, rather than to act as a mere agent as had originally been planned, and by the inefficiency with which that decision was carried out. The contingent liabilities arise mainly from breaches of contract and misapplication of funds improperly held in trust for Angus.

Term of Reference 2

" Whether any persons associated with the Council or its marketing operations received any direct or indirect benefits whether financial or otherwise, as a result of the marketing operations of the Council and whether it was proper or improper for such benefits to be given or received".

Many persons received perfectly proper benefits from FIC's marketing operations. Amongst those persons would be numbered all its paid staff and all its satisfied customers. I am reporting only on persons who received a substantial benefit which I consider to have been "improper" (See Sect.2 for full details). The main persons who received improper direct and indirect benefits were:-

Michael Cowan: flamboyant misuse of expense account, acceptance of gifts and services for himself and his wife, probably, secret "consultancy" fees and certainly K28,892.56 misappropriated by way of telex transfer to Toms of Straits (Singapore).

Miscus Maraleu: acquired a lucrative consultancy from Wawoi Guavi Timber Company in exchange for assistance given by Cowan and the FIC to that company over permit conditions and possibly by way of allowing a discount on Marketing Commission. The improper assistance given by FIC to his client MOI was also an indirect benefit to Maraleu.

Wawoi Guavi Timber Company: when the FIC took over as its sole marketing agent it charged a very cheap rate of commission, far below the deductions taken from the sales prices of most other producers. This and other services performed for it by Cowan were improper benefits received by WGTC from FIC. Other such services were the substantial assistance given to WGTC to help it terminate its marketing agreement with Inchcape (FMS) and the negotiation of a Timber Permit on very preferential terms.

Francis Sia and Malaysian Overseas Investment Pty Ltd: when Sia was unable to meet the payments due to the Bank of South Pacific on the purchase of his basic logging equipment Cowan improperly gave an FIC guarantee to the BSP and later diverted marketing proceeds held in FIC's USD account to pay off the bank when it called on the guarantee. Some of those funds were amounts due to S.J.Park as commission (and were paid with his approval). Other amounts seem to have been paid from FIC's own funds.

*where is p 305*



### Santa Investments

When Santa was in a desperate situation, through its own failure to pay export tax, FIC stepped in and used its authority to persuade Customs to clear the log shipments on the promise that tax would be paid from the proceeds. FIC itself arranged shipment of Santa's logs and then lined Santa up as the contractor for Angus. To what extent these benefits received by Santa were "improper" is a matter for debate.

### Stettin Bay Lumber Co

This company was granted 18,000 m3 p.a extra log export quota as a result of Cowan going behind the back of DOF Secretary Mamalai and dealing directly with Mr.Diro. This was additional to 30,000 m3 of extra log exports with which Mamalai agreed.

### Laki Sawmills and Amazon Bay Sawmilling and Lumber Co

Under the National Forest Policy these companies had no right to export logs taken pursuant to Native Timber Authorities. FIC undertook to "fix" that problem and used its authority to obtain export licences and then itself arranged shipment.

### National Forest Products

This company received an unexplained loan of K18,851.31 from FIC funds. FIC is still K7111 out of pocket.

### Term of Reference 7

" Ascertain whether and to what extent the functions of each of the Minister for Forest, the Department of Forests and the Forest Industries Council under the approved policy for the Forestry Industry identified under Term 5 have been interfered with or encroached upon by another or others of such functionaries or any other person".

### Interference with with Functions

The interference between these functionaries seems to have been all one way. Michael Cowan interfered with the functions of the Secretary DOF by secretly going behind his back to advise, brief and influence Minister Diro in the functions of his portfolio. It is a Minister's prerogative to seek advice from whom he chooses but the way Cowan managed to "capture" the Minister and persuade him in such matters as the allocation of the Vudal resource, the extra 18,000 m3 increase

in the permissible log exports of SBLC and the drafting of the Minister's letters and speeches, including statements to Parliament, constituted a significant interference with the Secretary's functions. The fact that Mr. Mamalai allowed this to occur is an example of his own weakness.

Cowan also interfered with the Minister's functions everytime he "tricked" him into making decisions previously "set up" by Cowan. Examples of this are the early commencement of marketing by FIC, about which the Minister really had no option except to retrospectively approve, and the drafting of pro-Weco decision's for the Minister to announce, which had actually almost certainly been drafted by Weco's own accountant Graham Ward. Although Mr. Diro thought he was making his own independent decision, the way Cowan had secretly structured it for him amounts to a serious and fraudulent interference with his Ministerial functions. In fact one could say that if an outsider gains such influence over the mind of a Minister as Cowan achieved over the mind of Diro, it is really an interference with the role of the Secretary for Forests and an interference with the performance by the Minister of his Ministerial functions. Other examples were persuading Mr Diro to approve the Pars Ram contract, persuading him to put pressure on VFP to sell Kwila and attempting to persuade him to expand FIC's role into control of log grading and selling through agents.

The questions of functions and interference with functions have already been dealt with in detail in sections 4 and 5 of this final report.

### Concluding Comments

It is apparent that FIC concentrated almost all of its efforts in encouraging direct sales to end buyers and in trying to eliminate unnecessary middlemen. In this endeavour it undoubtedly had some success and it achieved a significant increase in prices received by the PNG producers.

The FIC also put effort into acquiring data to establish a data base of obtainable buyer prices which was the used to revise MEP levels and later to make recommendation on the issue of shipment by shipment export licences.

It failed however to achieve any success in its traditional and primary function which was to promote PNG timbers by way of general market promotion and by diversifying markets and promoting our lesser known species.

In conclusion I have found that the FIC is not an appropriate body to be given the role of State Marketing Agency. It is controlled and funded by the timber industry and as such it is not capable of, and should not be asked to, control the industry.

(There are no pages numbered 310 or 311  
The next page is numbered 312)

8. GIVING, GAINING, RECEIVING AND REQUESTING IMPROPER BENEFITS.

Term of Reference No 8:-

"Establish whether any of, or any persons associated with, the Minister for Forests, any officer of the Department of Forests or any member or employee of the Forest Industries Council or any other person has received or attempted or sought to receive any direct or indirect benefits whether financial or otherwise as a result of or in connection with the allocation or promised or prospective allocation of the right to participate in any way in the exploitation of timber resources and establish whether it was proper or improper for such benefits to be given attempted or offered or received attempted or sought".

The practice of making payments to landowners, public servants, politicians and other leaders in order to gain access to timber and support for a timber operation is very widespread and spreading further.

Almost all timber operations, certainly all substantial operations, involve a foreign company or foreign backed company as permit holder or contractor. The funds for making these payments come from these foreign companies and frequently their source is the transferred profits which have been, or are to be, made from the operation. Such payments are an insidious form of foreign investment and the practice has created a social sickness. Particularly when these payments or other benefits are given to National political leaders or

parties they constitute a serious threat to Papua New Guinea's national integrity as they inhibit honest attempts to formulate effective forestry policy and pervert its implementation.

The improper benefits uncovered during my inquiries include cash payments, gifts of vehicles, golf clubs and other items, business partnerships, election campaign assistance, a free share in the equity of the operation, paid consultancies and retainers, a money sum per cubic metre and a fixed percentage of FOB price.

Most of the improper benefits reported upon in this section were discovered during the course of my investigations over the last two years. They have already been reported upon in detail in Interim Reports 1-6 which have previously been presented and are merely listed here in summary form as my final report on Term of Reference No 8.

Other improper benefits were only dealt with by way of public inquiry within the last few months have been reported upon briefly in interim report No.7 which is entitled "Current Events"

It sets out recent occurrences which suggest that many of the malpractices which have been investigated and reported upon by the Commission are still occurring despite extensive public exposure they have received over the last two years. In some instances the actors in these current "events" are the same people or companies which have previously been exposed.

The current events dealt within Interim Report No 7 are:-

1. Jaha LFA - Manus Province
2. Sebulon Watt and Tabar Island
3. Superior Tropical Timbers and Rai Coast Timber Area
4. Lower Sepik LFA and Michael Somare
5. West Gadaisu and Santa Investments.
6. Turama Timber Area and Long Term Trading
7. Arawe TRP - West New Britain
8. Francis Sia (MOI) and E. Tomon
9. Santa Investments - Public Hearing
10. Gasmata Resources.

On many occasions during this Inquiry evidence was given to the Commission clearly establishing requests for or payments of improper benefits to politicians, public servants and other persons associated with the forest industry. Nearly every Interim Report makes reference to such payments and benefits and the appropriate recommendations are made in each case.

For the purposes of this final report the summary of these findings has been divided into the following categories:

- National Ministers and their staff
- Other National Politicians
- Provincial Politicians
- Public Servants (National and Provincial)
- Lawyers
- Advisers/Agents
- Political Parties
- Managers of Landowner companies and Community Leaders
- Owner/Managers of foreign timber companies

1. National Ministers and Their Staff

(a) Edward Ramu Diro

- (i) As reported in Interim Report No 1 Mr Diro admitted, that while he was Minister for Forests, he wrote to Francis Sia of Santa Investments on May 15, 1986 requesting US\$127,500 to fund his political campaign for the coming elections. It appears that no payment was actually made.
- (ii) While part owner of Angus (PNG) Pty Ltd Mr Diro stood to gain substantial benefits from its Transfer Pricing activities.

An extensive list of payments and benefits given to Mr Diro, while Minister for Forests, from the Angus Group of Companies is contained in Interim Report No 2. (pages 44 and 45) and the circumstances in which those benefits were given are fully described in that report. The benefits included:-

- use of a Jaguar XJ6 Saloon and payment of expenses amounting to at least K10,000
- air fares for Mr and Mrs Diro to Singapore and return and from Singapore to Kuala Lumpur and return.
- payment of rent for Unit 306 at Pacific View Apartments amounting to K6,400.
- payment of Diners Club charges of K300



- payment of airfares for Mrs Diro to Sydney and return
- payment of airfares for Mr Diro and Mr Keith Anderson to Brisbane and return.

(iii) It is stated in Interim Report No 3 (page 177) that Mr Diro received free air tickets for himself and one member of his staff to Brisbane and also \$1500 in Brisbane from Pars Ram Punj, a businessman seeking access to PNG timber deals. (Mr Diro claimed to have repaid \$1200 of this sum). The benefits given to Angus amounted to indirect benefits to Mr Diro as he held 35% of shares in Angus. For example, Cowan of FIC became deeply involved in attempting to rescue Angus from its financial difficulties and negotiated on Angus's behalf. FIC took over marketing of Angus's timber and opened letters of Credit. These matters are reported in Interim Report No.3 Volume 1 at page 48 and constituted indirect improper benefits to Mr Diro.

(iv) Similarly, the payment of K5000 by Bruce Tsang to John Kasaipwalova, of which an amount of K4000 was retained by Angus, constituted an indirect benefit to Mr Diro due to his shareholding in Angus. This is summarised in Interim Report No.4 Volume 4A at page 91.

I have found all these payments and benefits to have been improper.

While I made no finding of impropriety in relation to Mr Diro's proposed commercial venture with Mr Chin Ah Eng of Gasmata Resources (outlined in Interim Report No 7) it was clear that a very real possibility had arisen for benefits to flow to Mr Diro and for his position as Minister to be compromised.

(b) Paul Torato and Lindsay Lailai

I have reported in Interim Report No.4 Volume 4A at page 91 that Paul Torato, as Parliamentary Leader of the United Party, received an indirect benefit in the form of a payment to Party Secretary Lindsay Lailai for his campaign expenses in 1987.

Similarly, it was clearly established that the United Party received more than US\$50,000 worth of election materials paid for by Santa Investments. (Interim Report No.7).

In both instances Mr Torato received an improper benefit. The payment to Mr Lailai was also improper. At the time the election materials were ordered Mr Torato was Minister for Forests and was making decisions which affected Santa's operations in the Gadaisu area in Central Province and in the area of Santa's operations in Namatanai. Santa's landowner company, Sopathin Development, had been seeking substantial increases in its area of operations which Minister Torato agreed to and expressly stated that Santa was to operate there.

(c) Stephen Raka

While working on the staff of Lucas Waka, during his term as Forests Minister, Stephen Raka received a total of K820 from Santa Investments. K700 of this was said to be in the form of loans.

On the 12 December 1984 Santa Investments agreed to supply Mr Raka with a Toyota Utility once their proposed project at Mussau Island commenced. (IR No.4 Vol.2 App. 4 Sch.13)

I find that the request for the vehicle and the receipt of money were both improper.

2. Other National Politicians

(i) Roy Evara

Santa's records show total payments of K5940 to Mr Evara. In addition Mr Evara has admitted requesting and receiving K2000 from Santa Investments (Francis Sia) to meet legal expenses. He has attempted to justify this on the basis of a personal friendship between himself and the Sia family.

I have found that in view of Mr Evara's position in the government, and as a parliamentary representative of the landowners in an area where Santa operated, that this request and payment were improper. (Interim Report No.7)

At the time of the requests and payments Santa was actively operating in the Vailala District of Gulf Province where Mr Evara wielded influence as a Parliamentary representative.

(ii) Noel Levi

Santa's records indicate a payment to Noel Levi of K500 on April 14, 1986. Mr Levi was regional member for New Ireland where Santa's major interests were. Mr Levi has not had an opportunity to explain this payment. In the absence of such an explanation I make no specific finding.

(iii) Gerard Sigulogo

In Interim Report No 4 Volume 2 Appendix 1 I made specific findings that Mr Sigulogo, when Member for Kavieng Open, received a free trip to Singapore and at least K2000 spending money from Francis Sia the principal of Malaysia Overseas Investment PNG Pty Ltd. At the time MOI was operating in Sigulogo's electorate. Mr Sigulogo received improper benefits from Francis Sia and the timber company Malaysian Overseas Investments. He sought K30,000 from proceeds of shipment sales and in return promised "that you will continue to operate as long as I am a Member of Parliament".

I have made a finding that Mr Sigulogo's actions were improper and I have recommended that they be referred to the Commissioner for Police and to the Ombudsman Commission.

3. Provincial Politicians(a) Robert Seeto

Interim Report Nos 4 Volume 4A and IR 7 at page 94 deal with a number of instances where Mr Seeto, when

Premier of New Ireland, sought cash payments including K21,000 from Santa and received considerable sums from people or companies involved in the PNG timber trade either for himself personally, for his associates or for the Peoples Progress Party. These requests and payments were directly related to the favours he could (and did) offer to perform.

The requests made by Seeto to both Francis and Michael Sia are dealt with in this IR No 7. I have noted on a number of occasions that criminal proceedings were taken against Mr Seeto. I was advised by the office of the Public Prosecutor that these would now proceed by way of ex officio indictment. I do not, therefore, propose to comment further on them. (Most recent indications are that no indictment will be presented).

I have recommended that payments made by Bruce Tsang to Mr Seeto totalling about K40000 (IR No.4 Vol.4A page 105) as well as those allegedly made by the Sias and Santa Investments be referred to the Commissioner of Police to consider whether to institute criminal proceedings.

(b) Sampson Gila (New Ireland)

It is clear from correspondence passing between Robert Seeto and Michael Sia (Interim Report No.7) that Sampson Gila received at least K2000 from Santa Investments. The letter seeks an additional K3000 as the final payment towards Mr Gila's election expenses. After hearing evidence from Mr Gila I have found that these payments and requests were clearly improper. I have also found that Gila was receiving other payments which were put towards the purchase of his house in Kavieng (IR No.4 Vol. App. 2).

(c) Ope Oaeka (Gulf)

By an undated letter addressed to Michael Sia Mr Ope Oaeka sought payment of K5000 to meet election expenses. Mr Sia denied that the payment was made.

Although Mr Oaeka has not had an opportunity to explain the request he made it is clear from its terms that he was seeking an improper benefit.

(d) Other New Ireland Politicians

In Interim Report 4 Volume 4A at page 98 I commented on the relationship between Bruce Tsang and a number of provincial politicians and I referred to the apparent practice of making various goods available to them but I was unable to make any specific findings as to the payment of improper benefits.

4 Public Servants (Provincial and National)

(a) Oscar Mamalai

In Interim Report No 2 (page 54) I was forced to the conclusion that the only explanation for Mr. Mamalai's conduct in relation to Angus was that he was receiving some benefit or that he was subject to considerable pressure being exerted on him.

Mr Mamalai admitted in a statement to the Inquiry that he met Mr. Chin Ah Eng while he was holidaying in Singapore with his wife. On that occasion Mr Mamalai

received two sets of golf clubs from Mr Eng and his wife was given K2500 for shopping. Mr Mamalai revealed that Mr Eng put up K10,000 to fund a proposed business venture with Mrs Mamalai.

Although Mr Mamalai claimed that the receipt of these payments did not compromise his position as Secretary, I have found that he acted improperly in relation to the pre-registration of Eng's company, Gasmata Resources.

The payments and gifts from Mr Eng were clearly improper benefits for Mr Mamalai and his wife. I have recommended that the police undertake further investigations.

(b) Jack Masu (New Ireland)

It is stated in Interim Report No 4 Volume 4A at page 101 that the regular receipt of many free cartons of beer by Jack Masu from Bruce Tsang was an improper benefit which compromised him in his position as provincial forests officer.

(c) Dennis Hoivo (Central)

In Interim Report No 2 at page 55 it is stated that Dennis Hoivo received a bribe of K1000 while holding the position of a Central Provincial Forest Officer. In return for this payment he admitted acquiescing to the loading and shipment of logs by Angus prior to payment being made for royalties and export tax.

I made the recommendation that this matter be referred to the Commissioner for Police.

(d) Other Public Servants

The financial records of Santa Investments appended to Interim Report No 7 indicate widespread and substantial payments to unnamed public servants responsible for regulating nearly every aspect of a foreign company operating in the forest industry in Papua New Guinea.

These payments were admitted by Michael and Francis Sia. The records indicate payments to:

migration officers  
forests officers  
customs officers  
a NIDA officer named Polsu  
a Labour officer at Kerema.

These payments are improper.

(5) Lawyers

(a) Miscus Maraleu

- (i) In Interim Report No 3 at page 176 it is stated that lawyer/consultant and FIC chairman Miscus Maraleu obtained a lucrative consultancy agreement from Wawoi Guavi Timber Company in return for assistance given by FIC Executive Director Cowan and the FIC to that company over permit conditions and by way of allowing a discount on Marketing Commission. It was also found that the improper assistance given by FIC to Maraleu's client Malaysian Overseas Investments Pty Ltd was also an indirect benefit to Maraleu.



(ii) In Interim Report No 4 Volume 2 at page 34 it is stated that the payment of K1500 per month from MOI to Maraleu's company Metepikai Holdings was an improper benefit to Maraleu in the circumstances.

(iii) The actions of Mr Maraleu as a lawyer and as Chairman of both the FIC and the Investment Corporation have on occasions, been disgraceful and reprehensible. These instances are summarised in Interim Report No 4 Volume 4A at page 92 and I have recommended that his actions be referred to the PNG Law Society for it to consider whether he is a fit person to continue practising as a lawyer.

(b) Sebulon Watt

(i) From the records of Santa Investments it is clear that Mr Watt sought and received substantial payments from that company. This was in spite of the fact that he was at the same time engaged as the lawyer for Sopathin, the landowner company with which Santa was dealing (and which it was cheating)

(ii) It was also admitted by Watt that he acted as courier for Mr Seeto to deliver letters to the Sia Brothers, to collect cash from them and to deliver these payments to Seeto. There can be no question, from his own evidence, that Mr Watt was well aware of nearly every aspect of Mr Seeto's dealings with Santa and the Sia Brothers. He also received substantial cash sums for himself and the use of a vehicle.

- (iii) In Interim Report No 4 Volume 2 Appendix 2 at page 20 it is noted that Mr Watt was involved in the "secret operations" on Tabar Island. In his capacity as a lawyer Mr Watt appears to have acted for both the landowner company Tabar Timber Development Corporation. (TTDC) and Byron Consultants despite an acute conflict of interest.

From his evidence given at the time of the hearings concerning Santa's improper payments it is clear that Mr Watt is once again involved in illegal operations on Tabar Island and has willingly permitted himself to be bound up in another conflict of interest situation.

- (iv) In Interim Report No 4 Volume 4A at page 92 it is stated that Mr Watt regularly and improperly acted in assistance of Bruce Tsang's dealings. It is also noted that he was in a clear conflict of interest situation in relation to Noatsi Development Corporation, Nakmai Co and Patpatar Enterprises.

In view of his position as a lawyer acting unethically in acute conflict of interest situations and in view of the nature of the payments and profits he was receiving I have found that these receipts amounted in many instances to the receipt of improper benefits. I have also recommend that his actions be referred to the PNG Law Society for consideration as to his fitness to practise as a lawyer.

(c) Gerard Kassman

Mr Kassman's actions in relation to his acting for Bruce Tsang and Angus have been noted in Interim Report No 4 Volume 4A at page 93 and Interim Report No.2 respectively. While there have been no findings that Mr Kassman received improper benefits it is clear that his actions, on occasions, were in clear breach of his legal and ethical duties as a lawyer. In Interim Report No 2 at page 58 I referred matters relating to Kassman's involvement in Angus to the Registrar of Companies, the Papua New Guinea Law Society and the Commissioner for Police. I also referred him to NIDA for assisting Bruce Tsang to avoid NIDA registration for Sakai Management and Nationwide Consultants.

6. Advisors/Agents

John Kasaipwalova

(i) It is noted in Interim Report No 2 at page 54 that Kasaipwalova and F C Cheah received inordinately high salaries and allowances from the ailing Angus.

(ii) It is noted in Interim Report No 4 Volume 4A that Kasaipwalova acted improperly in relation to the obtaining of log export permits from Kabil LFA and that the payment he received in relation to this was grossly excessive.

In the circumstances I have found that Mr Kasaipwalova received improper benefits from his involvement in the PNG timber industry.

## 7. Political Parties

### (a) People's Progress Party

It is clear from Interim Report No 4 Volume 4A at page 99 that the Peoples Progress Party received contributions from Bruce Tsang and at one time stood to receive considerably more.

It is clear from the financial records and the letters appended to Interim Report No 7 relating to Santa Investments that Santa contributed at least 2 and may be 3 motor vehicles to the party in New Ireland. It appears that the requests were made by John Chan and that payments were made through Morris Ling in Kimbe. (Appendix 4).

Despite Mr Ling's contention that he knows nothing of cash payments recorded as having been made to "Lucy" I am satisfied that Morris Ling is "Lucy" as referred to in the financial records of Santa and that these records accurately record payments of more than K80,000. It is beyond doubt that the payments recorded as having been for motor vehicles were correctly recorded and were received by Ling. I reject Michael Sia's claim that the other three payments of "cash advances" were incorrectly recorded. Simon Sia confirmed that he only made entries at Michael Sia's direction and I cannot accept that the same mistake could have been made on three separate occasions. However, attempts to trace the cheques through the Bank of South Pacific were not successful.

(b) United Party

- (i) It is clear from Interim Report No 4 Volume 4A at page 99 that Bruce Tsang contributed toward the expenses of United Party candidate, Lindsay Lailai.
- (ii) I am also satisfied from the financial records kept by Santa Investments Appended to Interim Report No 7 and from the evidence of Michael Sia that Santa paid in excess of US\$50,000 for election materials supplied to the United Party at a time when it was seeking and received approvals for its timber activities from the Minister for Forests and United Party leader Paul Torato.

(c) Pangu Pati

It is noted in Interim Report No 4 Volume 4A at page 99 that Tsang gave evidence that he had given K4000 to Miskus Maraleu to give to a Pangu Pati politician in West New Britain. This was denied on oath by Maraleu and no documentary evidence was found to support it. I can make no finding on this matter.

(d) Peoples Action Party

It has already been noted that Mr Diro admitted requesting payment of US\$127,500 for his party from Francis Sia. It appears that the payment was not made.

It is also stated in Interim Report No 2 that Mr Diro claimed that US\$150,000 paid into an undisclosed bank account was given by a Mr Chen, a business partner of Mr Diro in Australia, for the benefit of his political

party. When confronted with evidence that Mr Chen was at that time seeking a timber concession from him as Minister for Forests Mr Diro changed his sworn evidence and swore that the money came from General Benny Murdani the head of the Indonesian Armed Forces to fund the campaign for his party. This evidence put the matter outside the terms of reference of the Inquiry as there was no proof that it was related to the PNG timber industry.

#### 8. Managers of Landowner Companies and Community Leaders

The reports contain many references to payments and other benefits being given to community leaders and to landowner company Directors, Secretaries and employees to win their loyalty and support for the operations of a foreign timber company. In cases when these people owed a duty of support to the landowner company which their foreign benefactor was defrauding and cheating and to the community whose resource the foreign company was exploiting these "benefits" were, at least morally, improper. By means of these payments foreign timber companies have gained necessary signatures and approvals to allow their operations to commence and continue. Because the beneficiaries of these payments and benefits lent their vocal support to the political lobbying of these companies they have been able to gain the improper and irregular approvals from forest Ministers and public servants which have badly distorted the orderly development of the PNG timber industry as recorded in the various reports submitted by this Commission of Inquiry.

9. Owner/Managers of Foreign Timber Companies

The reports of this Commission of Inquiry also disclose the very substantial secret profits made by foreign companies from various forms of "transfer pricing", by undergrading and undermeasurement and by various other means of cheating and defrauding landowner companies and resource owners of their rightful entitlements. Investigations also uncovered widespread illegal practices aimed at avoiding payments of Group and company taxes.

All benefits sought or obtained by these means by foreign companies and their principals are improper benefits within my Terms of Reference. Wherever possible I have publicly disclosed these benefits and also brought them to the notice of the Chief Collector of Taxation (where appropriate) and he has been taking his own independent action to recover evaded tax revenue.

The following is a brief summary of the companies and individuals involved in such practices who have thereby obtained improper benefits:

(a) Angus (PNG) Pty Ltd

Interim Report No 2 makes reference to the following matters relating to transfer pricing practices by this company:

- (i) a proposed arrangement to transfer price in the amount of US\$10 per cubic metre on all shipments. (page 24)

- (ii) an arrangement made through Angus (Hong Kong) in relation to the first shipment in which the sum of US\$59,744.76 was transferred (page 25).
- (iii) an arrangement made through Angus (Singapore) in relation to the second shipment in which the sum of US\$52,536.05 was transferred (page 34).
- (iv) an on-going agreement to enter into transfer pricing arrangements on every shipment with an anticipated total of US\$9,408,000 over the entire period of the permit (page 30).

There is also mention in Appendix 50 to Interim Report No 2 of evidence indicating the smuggling of liquor and the avoidance of customs duties.

(b) United Timbers Pty Ltd

It is reported in Interim Report No 4 Volume 1 at page 64 that United Timbers engaged in transfer pricing activities through Hong Kong for a two year period. These activities involved about K1.1 million for which the company has now agreed to pay base tax of K385,000.

It is also reported at pages 81 and 82 of that Report, and supported by Schedules to Appendix 4 of Volume 2, that the company's practices of under-grading and under-measuring logs resulted in improper benefits amounting to in excess of US\$1.5 million (rather than the K1.1 million admitted by the company).



(c) Shin Asahigawa

It is reported in Interim Report No 4 Volume 1 at page 65 and more extensively in Interim Report No 6 that transfer pricing by this company amounted to as much as K6,123,250 in the period 1981-1986. The company has now accepted a tax liability of K1.7 million in respect of this.

It also appears that the company avoided group taxes to the extent of K200,000.

(d) Santa Investments (PNG) Pty Ltd

It is reported in Interim Report No 4 Volume 1 at page 65 that transfer pricing by this Company amounted to as much as K1,235,000 in 1986. In Appendix 3 to Volume 2 (page 16) it is stated that the company evaded Group Tax in the sum of K250,000.

It is also reported in Interim Report No 7 that the company engaged in transfer pricing in the sum of US\$91,635.70 on three shipments in 1986 from its operations in Gulf Province.

(e) Gaisho Co. (PNG) Ltd.

It is reported in Interim Report No 4 Volume 1 at page 66 that for the entire fourteen year period of this company's operations in Papua New Guinea this company engaged in transfer pricing activities. This is likely to have exceeded K6 million.

It is also clear that the company has avoided its liability to pay group tax although an amount could not be calculated. (Interim Report 4, Volume 3 at page 64).

(f) Lusco Pty Ltd.

It is reported in Interim Report No 4 Volume 1 at page 79, in Volume 2 Appendix 5 and in Interim Report 6 Volume 4 Appendix 8 that this company engaged in considerable transfer pricing but an amount could not be calculated. This was done through a Hong Kong company owned by Lusco's Rex Grattidge.

(g) Sumitomo

The substantial benefits by the purchasing of logs at less than their market value by this company are referred to in Interim Report No 4 Volume 1 at page 79 and more extensively in Interim Report No 6. It is not possible to determine the extent of these benefits in monetary terms.

(h) Bruce Tsang

The appalling conduct of Mr Tsang is referred to in Interim Report No 4 Volume 1 at page 79 and more extensively in Interim Report No 4 Volumes 4A and 4B. These activities include transfer pricing in 1986 and 1987 by as much as US\$450,000.

I noted in my concluding remarks to Interim Report 4 Volume 4A at page 106 that Mr Tsang's illegal practices had defrauded landowner companies of hundreds of thousands of kina.

(i) Francis Sia and Malaysian Overseas Investments Pty Ltd.

Mr Sia's dealings with Mamirum Timbers were disgraceful and are reported in Interim Report No 4 Volume 2 Appendix 1 at page 11.

In addition to his dubious marketing practices Mr Sia charged exorbitant and improper fees which he deducted from the proceeds of log shipments. For example, from the proceeds of one shipment being K284,236.12 he deducted K186,507.19 in administration and other charges, he then retained his 75 percent share of the profits and effectively paid only K1,843.99 to the landowner company.

This was by no means an isolated incident in his dealings with landowners and their companies.

(j) Stettin Bay Lumber Company Pty Ltd.

The marketing practices of this company which is partly owned by the State are reported in Interim Report No.6 Volume 3 Appendix 5. There is clear evidence of transfer pricing activities through Hong Kong and Japan totalling in excess of K3 million.

(k) Wawoi Guavi Timber Company

In Appendix 1 to Interim Report No 5. I noted the difficulties encountered when investigating the marketing activities of this company. These included extremely complex corporate interrelationships and also the fact that such matters were directly relevant to proceedings in the National Court between the company and the Inchape group of companies. Notwithstanding these matters I made

a finding that substantial sums of money were transferred offshore although it was not possible to determine exactly how this was achieved or the extent of it in monetary terms. It was clear that the payment of excessive marketing commissions amounted to transfer pricing.

(e) Open Bay Timber Co

The Marketing practices of this company which is again partly owned by the State are reported in IR No 6 Volume 4 App 6. It benefitted by not performing onshore processing obligations which it originally undertook, and from substantial undergading and transfer pricing on sales to its parent company for resale by it.

(m) Tonolei Development Corporation

In earlier times there was clear undermeasuring and freight manipulation. The companie's marketing requires further investigation (see IR No 6 Vol. 4 App.9)

(n) Bismark Industries

The marketing practices of this company are reported in IR. No 6 Vol. 4, App.7. It benefitted by not performing agricultural and forest plantation obligations and from transfer pricing through related Hong Kong companies to a related (reseller) company) in Japan.

(o) Nam Yang Timbers

The marketing practices of this company are briefly reported in IR No 6 Vol.3 App.3. It appears that it benefitted by systematic transfer pricing through a Hong Kong company

### Conclusion

I was forced to make the most unfortunate finding that every company operating in New Ireland Province that was studied by this Commission was engaging in or had clearly engaged in transfer pricing activities. It has been reported that companies marketing through one of the trader companies sometimes entered into secret financial arrangements for the trader to arrange unfair sale prices. In other instances the trader companies would arrange unfair prices for entirely their own benefit. (see discussions in Interim Report No 4 concerning Bruce Tsang and Lusco). This situation applied to nearly all companies studied elsewhere in PNG.

In some instances it was not possible to pursue the investigations to their conclusion and in relation to companies such as Nam Yang, Bismark Industries Open Bay timber, Timber Tonolei Development Coporation and others I have recommend that further investigations take place. In relation to every one of the companies or persons named above I would most strongly recommend strict and regular examination of their activities to ensure that such practices are not continuing.

I have already recommended that the activities of many of these and other companies and persons be referred to appropriate authorities for investigation and appropriate follow up action.

I also recommend that the Minister for Forests should examine closely all aspects of their activities to see which of them may be unfit for continued or further involvement in the PNG timber industry. He should also consider which companies should be warned and subjected to far more careful scrutiny in future. I recommend that

performance guarantee bonds should be required as a condition of any new approvals to be granted to these persons and companies and that ways be sought to introduce such bonds and other "security" measures into the conditions of their existing operations whenever this is legally possible.

#### Santa Investments and Gasmata Resources

In the final stages of this Commission of Inquiry I directed that the investigations into the activities of Santa Investments and Gasmata Resources be concluded. Public hearings were subsequently held.

My findings in relation to the practices of these two companies are reported in Interim Report No 7. The detailed documentary evidence is included as Appendices 4 and 5 to this report scheduled that report.

The findings show clearly that these two companies made payments of improper benefits to promote their forest operations in this country. I am well satisfied that the principals of these two companies set about in a deliberate and calculated way to compromise politicians, public servants and persons of influence to advance their own personal and corporate interests.

The narrative relating to both Santa and Gasmata provides very clear illustrations of the improper conduct by some companies involved in the timber industry. In Santa's case there is abundant evidence of widespread cash payments to politicians, officials, and landowner companies. In the case of Gasmata it is clear that the practice was to establish firm and on going commercial relationships with the Minister and Departmental Head.

In the case of Santa Investments I also made findings of further transfer pricing activities of the kind referred to above and stated to be improper benefits to the companies undertaking such practices.

## 9. CONCLUDING COMMENTS

This has been a very wide ranging factual investigation. The Angus investigation with its revelations of Ministerial impropriety and transfer pricing led on to a full study of the New Ireland timber industry where again it was disclosed that transfer pricing and misconduct by politicians and public servants has been rampant. When mainland companies were examined the same disease was disclosed.

The Commission made a full study of the desirability of having a State Marketing Agency as a method of reducing the problem of transfer pricing and of the involvement of the Forest Industries Council and the Department of Forests in this role. In Section 7 I have recommended the continuation of this State Marketing role as one essential weapon in the fight against transfer pricing. The full findings on the FIC and the discussion upon which these recommendations are based appear in Interim Reports 3 and 6.

A major focus of the Inquiry has been on this whole question of the marketing of timber. A complete coverage of this subject is set out in the four volumes of Interim Report No 6 which shows that virtually none of the existing control mechanisms are working effectively. These findings are very briefly outlined in Section 6 of this Report.

One worrying aspect which has emerged from this Inquiry is that the knowledge of the forest resource base is not accurate. It is not a reliable basis for planning the orderly exploitation and long term protection of the forests.

Throughout the two years of this Inquiry there has been continuous observation of National Forestry Policy



in action. The focus has always been on what the government is doing or is allowing to happen - not what it states its policy to be.

The Commission postulated thirteen broad policy principles based on documentary sources and then set about testing government performance. The thirteen postulates may not comprise a complete coverage of all major aspects of policy, and they could be worded differently, but I believe they are sufficient for my present purpose. The important passages occur in the sections dealing with performance evaluation because those sections contain a clear statement of what is actually happening (or not happening).

The statement of defacto policy is based on my findings on these matters of fact. For example:

local processing is being allowed to decline alarmingly;

there is little emphasis on reafforestation;

sustainable yield forest management is not being practised;

decentralisation policy is not being implemented;

foreign investment is being allowed to dominate the timber industry and now compromises PNG's national integrity;

log exports have been allowed to increase to massive proportions and the 1979 guidelines to control that situation are not being followed.

Under the heading "Current National Forestry Policy" there is a series of statements based on my findings about what is actually happening. They are, unfortunately tinged with cynicism but that is the inevitable result of spending two years studying the factual practices beneath the verbal declarations.

The study of Policy set out in Section 3 has thrown light on what is actually happening in the timber industry. It has shown the complete lack of any clear statement of policy for government and industry to follow. It is a major lack and needs to be remedied urgently.

The expected World Bank report on Policy may well be the basis for remedying this defect. My report does no more than state authoritatively what is now happening.

The Report sets out in Section 4 the functions of the Minister for Forests, the Secretary (DOF), the NEC, the FIC and Provincial Governments. This part of the report is based on the relevant legislation and Constitutional provisions.

Interference with functions is dealt with in Section 5. It mainly concerns Cowans' reign at FIC where he extended his influence in ways which interfered with the functions of the Secretary and Minister for Forests. The payment of improper benefits also interfered with proper functioning of the Ministry and Department of Forests. Some examples of strong political intervention are also discussed.

Improper benefits: During the course of the inquiry numerous instances were discovered of leaders giving, receiving or seeking improper benefits. These are dealt with in the relevant Interim Reports and summarised in Section 8 of this Final Report - together with my recommendations for referral for follow up action.

In Section 6 of this Final Report, which deals with Marketing, there is a brief summary of my findings on transfer pricing and other devices used by timber companies to falsely lower the disclosed value of their

exported product or to falsely inflate the disclosed cost of their imported goods and services. The full details of these practices are set out (in four volumes) in Interim Report No 6.

One very worrying aspect is that despite the regular public disclosures of transfer pricing, bribery and improper practices it is still going on.

Thus in the months between the completion of the New Ireland Inquiries and the completion of the Report on those matters, similar practices were again occurring - (see update to Interim Report No 4. Vol 1). The situation is so bad that I added an unplanned 7th Interim Report "Current Events" to again illustrate that there needs to be a continuing "watchdog" presence over the unruly timber industry.

#### RECOMMENDATIONS

It was not part of my terms of reference to make recommendations and for this reason I was unable to expend funds and effort on studying various options for improving the present situation. Nevertheless, at the end of this long Inquiry there are various courses of action which I feel should be followed or at least be given careful consideration. I offer these thoughts in the form of recommendations.

##### 1. Commissions of Inquiry

In relation to the Commissions of Inquiry Act and the administration of it I make the following observations and recommendations:

#### A. Offences under the Commissions of Inquiry Act

Existing problems concerning the offences under the Act must be remedied. The purpose of a Commission of Inquiry is to obtain facts and to advise the government on important matters of public interest. The Act restricts certain individual rights to meet this end. A person cannot choose to remain silent before a Commission of Inquiry and he cannot (normally) refuse to answer a question. The reason for waiving an individual's right to remain silent in this way is to enable the desired information to be made quickly available to the Prime Minister and then to the public. To offset possible injustice which may be caused to an individual witness by these enforced disclosure provisions the Act protects him from subsequent civil or criminal prosecution to the extent that his evidence before the Commission cannot be used as evidence against him in subsequent civil or criminal proceedings.

#### Refusal to attend or to answer questions:

It is essential that there must be strict penalties for refusing to answer a summons for refusing to answer a question or for lying on oath. At present the maximum penalty for refusing to attend is a fine of K100. Faced by such a weak sanction several witnesses (with plenty to hide) simply avoided appearing altogether. I was then faced with the dilemma of whether to proceed without the witness or to devote valuable staff time to engage in the complicated business of prosecuting him. In each case I chose to proceed in the witness's absence and made my findings on the basis of clear documentary evidence. But the situation is most unsatisfactory.

I recommend that the penalties for failing to attend or to answer questions before a Commission of Inquiry be substantially increased.

### Perjury

With regard to perjury the Commission's experience is very significant. In the first year of its operation I frequently experienced the situation of hearing witnesses who were clearly lying under oath or (in the case of several non-Christian Asian witnesses) of lying under affirmation. On many occasions I was able to stop the proceedings and warn the witness that the penalty for committing perjury before a Commission of Inquiry was (as I, and the legal profession generally then believed) fourteen years imprisonment. Faced with this possibility several witnesses then completely changed their evidence and confessed to various malpractices. The prime example of this was Mr E.R. Diro who changed his evidence several times though he still did not come clean with the whole truth. After I warned him that he would be charged with perjury he finally gave evidence relating to General Murdani and the source of funds received from overseas and on other matters.

On his own evidence Mr Diro had clearly been repeatedly lying under oath and I directed that he be charged with three counts of perjury. The eventual result of that long and expensive prosecution and appeal process was a Supreme Court Ruling on 5 August 1988 that lying under oath before a Commission of Inquiry was not punishable as a criminal offence because of a defect in the way the legislation had been drafted. (Pending final determination of this matter the seriousness of a perjury charge was clear to all witnesses and it was demonstrably a potent factor in the minds of several witnesses who made unexpectedly candid admissions.)

The Supreme Court decision dramatically reduced the effectiveness of all future public hearings. Without the threat of criminal prosecution for false evidence it simply was not worthwhile calling several key witnesses to explain their actions as cross examination would not be effective and the evidentiary value of their evidence was badly reduced because I knew, and they knew, they could lie without earthly sanction. For the many non-Christian witnesses they probably faced no heavenly sanction either.

A crippled Commission limped on for eleven long months waiting for a promised amendment to the Act which would create for it the offence of perjury. The amendment is still not enacted. I recommend that the Act be amended to create an offence of Perjury as soon as possible. In the meantime there is little point in establishing further Inquiries of this nature which will depend upon truthful evidence given in public hearings. (On occasion I requested witnesses to put their evidence in the form of a Statutory Declaration so that they at least faced a lesser penalty for swearing a false declaration).

#### Power of Search and Seizure

I found that the Commission had insufficient powers to enforce (in practical terms) the production of all relevant documents in a person's possession. On three occasions the Commission had great success in achieving full production and it set the course for the whole Inquiry. That success, however, was due to special factors:

- (a) Angus (PNG) Pty Ltd was under official management and the manager co-operated fully by making all Angus files and documents available to the Commission.
- (b) With Michael Cowan out of the country I successfully obtained all FIC files on summons.

The combination of the Angus and FIC files, including the copies of all inwards and outward telexes and facsimiles, disclosed significant links throughout the timber industry. Following up those leads was a major stimulus to the investigation.

- (c) Acting on information supplied by the Commission the police did what I could not. They raided Santa's offices and seized documents, some of which I then obtained from the police by way of summons. Had I served a summons on Santa in the first instance I fear the documents would have been destroyed, mislaid or altered.

I recommend that the Commissions of Inquiry Act be amended to give a Commission the power to issue warrants to enter and search premises and to seize all documents relevant to its terms of reference. The power would need to be subject to appropriate safeguards against abuse and subject to the provisions of the Constitution.

#### B. Commission's Administrative Matters

The Commission commenced work in April 1987 on a limited short term inquiry with one counsel assisting, an executive officer and a secretary. After the terms and the period of inquiry were extended I sought the services of a national legal officer to assist Mr Reeve and to gain the invaluable experience of working for such a Commission. My request, which was repeated in mid term and towards the end of the Commission's life was refused because no national lawyer could be found in the government ranks and there were no funds to brief a

national private practitioner. The result is that the capability of servicing the next Commission of Inquiry has not been built into the system. Assisting a Commission of this nature as Counsel is a skill which can only be learned by experience - it is not taught in Law Schools - and a valuable opportunity has been lost.

In retrospect it is now apparent that the Commission has been badly understaffed and has suffered as a result. With only one Counsel it reduced the days devoted to public hearings by at least half.

This Commission badly needed full time investigators, extra secretarial assistance and three Counsel assisting. With that sort of support staff three teams could have worked simultaneously. Each lawyer should have had a secretary, a word-processor and two investigators. One team would investigate and prepare for public hearings a month in advance and would have been able to present the Commissioner with a full brief, a detailed opening address and list of witnesses. All documents and witnesses would have been summonsed well in advance. While that team was preparing ahead, a second team would be presenting its cases at a public hearing, while the third team would be writing up the result of its investigation and (just completed) public hearing. It would also be preparing a draft report in consultation with the Commissioner and sniffing out its next investigation. In this way the work of this Commission would have been prepared and documented thoroughly and the inquiry would have been completed in about one year. The Commissioner would have devoted his time more fully to conducting public hearings and finalising reports.

Without that sort of support staff I was forced to rely on the (willing) services of Mr Johnson Mantu of the



Department of Forests and other officers as required and available. For a period I obtained permission of the Chief Collector of Taxes for Mr Roe to assist the Commission in its inquiries into marketing. By moving its premises to the National Court House the Commission obtained the willing service of several secretaries who were generously made available by my brother judges when they were out of town on circuit. Thus by a patchwork of ad hoc arrangements the strength of the Commission was increased beyond its official skeleton framework. Such ad hoc arrangements however cannot form the base for a well planned and efficient working system.

The extra staff and facilities would have cost more money but that needs to be seen in perspective. The cost of this Commission to the Prime Minister, for its entire period of 26 months, was K282,763. Including the cost of services provided by the National Court the total cost for the entire period was on K470,863. As against that cost the government has already collected more than K4 million in extra taxes as a result of the Commission's exposures and at least another K6 million is presently being negotiated for collection.

(A comparison with the Fitzgerald Commission in Queensland which ran more or less concurrently with this Commission would show that it was provided with a team of lawyers and a team of investigators and support staff. Its cost is said to have exceeded AUD20 million and the scope and difficulty of its terms of reference were far less than this one.)

The major and insurmountable obstacle to planning a truly efficient working system however has been the continuing uncertainty about the length of time available for completing the Commission's unmeasurable task. At no time was the Commission told to take as long as it

requires to do the job. From the date of its first three month extension of time, the Commission has existed on grudgingly given three month extensions. As the end of each current extension approached the almost invariable experience was a battle of wits to assist the Executive to see that it was physically impossible to complete the work by the given time deadline and that it was unacceptable that the Commission should cease before the task was completed. I give credit to both the presiding Prime Ministers that, when they saw the reality behind the struggle, they granted an extension in every case.

In the last period the extensions were from month to month and most recently by a week at a time. My point is, and I recommend, that any future Commission faced with such a wide and massive task should be assured of generous periods of time to plan and complete its task. This is particularly so if the Commission is reporting continuously, as I did, by way of regular progress or Interim Reports.

I also recommend that future Commissions of this nature be set up with sufficient counsel and staff to enable them to rotate the tasks of investigating, preparing and presenting evidence.

With those criticisms expressed I wish also to express my appreciation to the Secretaries of the Departments of Prime Minister and Forests for their co-operation and for the services of their officers who invariably performed the tasks required of them with willing attentiveness.

## 2. Policy

My only firm recommendation about forestry policy is that I recommend that all efforts must be made to formulate and gain NEC, provincial government and indus-

try approval for an appropriate statement of policy as soon as possible.

The formulation of a comprehensive and clear National Forest Policy is of paramount importance. This cannot be done on a piecemeal basis but must include input from all relevant agencies including the Departments of:

Forests, Lands, Trade and Industry, Agriculture and Livestock, Works, Environment and Conservation, Finance and Planning, Customs, Taxation, etc.

Provincial Governments having significant forest resources must also be fully involved. I hope my very detailed section 3, where the working of existing defacto policy or practice is fully described, will assist the working group detailed to formulate this policy. The Commission's working paper at Appendix 1 may also be of some help. The anticipated report from the recent World Bank team is expected to make detailed reference to policy requirements and possibly the Bank will assist with aid to formulate the policy itself.

In my opinion it is necessary to start from scratch and to formulate, and then to begin to answer, the most basic and fundamental questions about what is required of forestry in Papua New Guinea.

### 3. Legislation

I must stress that the formulation of the National Forest Policy must precede the revision of the existing forest laws. These laws must reflect all aspects of the approved policy. There is a need for very substantial legislative reform but it can only lead to the desired benefits if it is soundly based on a well considered policy.

Again the report by the World Bank team may be a good basis for the revision of the laws. It is understood that the Report will address such matters as the establishment of Regional Forestry Boards and appropriate controls on Ministerial power. It also requires the establishment of a single forestry service which can be established by the legislation and be vested with the appropriate powers. I understand the report will include a draft outline for new legislation.

#### 4. Administration of Forestry

I recommend the establishment of a single forestry service. The service should be responsible to a body with regional representation and therefore it could be made to be responsive to the needs of the provinces. It should be primarily responsible for enforcing the provisions of the National Forestry Policy according to an agreed National Forest Plan. Full account must be taken of the implications of the decentralisation policy but national control must be retained to ensure the protection and proper exploitation of the forest resource.

The major opportunity for provincial government input into forestry decision making should be by full participation at the drawing up of provincial and National Forestry Development plans and at the preparation of the detailed programmes in which preparation for, and allocation of, resources are scheduled. The planning must be very detailed. It must commence with an accurate and up to date survey of the resource and must include the full package of conditions intended to benefit the landowners and the province. These must be worked out in full and meaningful consultation between landowners, provincial governments and the controlling Authority. The principles of

sustained yield forestry and the principles of damage assessment must be clearly specified before allocation occurs and these principles must be itemised in specific plans before allocating the resource. All feasibility studies also should be completed before allocation of the resource.

To ensure the province has an effective voice in the administration of forestry I recommend that the provincial government should be given the power to veto a project from being included in its provincial forestry plan if it cannot reach agreement with the (national) governing authority.

Existing Forestry staff are inadequate in terms of numbers, experience and expertise. Only a very few of the senior officers were trained in a tight and controlled system. The great majority have grown up within the present loosely controlled system where rules are made to be broken if they will not bend. Most field inspectors have never seen a proper logging operation where the control systems are in place and are being enforced strictly.

In the short term I recommend that experienced key personnel be imported from outside at every level, to spearhead planning, surveys, operations and marketing controls. Whether this is done on an individual contract officer basis or by hiring an overseas agent like SGS, I leave to be decided by the appropriate authorities (though I favour the latter approach on a strictly short term basis). An effective on-the-job training programme for local officers must commence immediately so national officers can replace the foreigners as soon as possible in accordance with a firmly fixed timetable.

I realise that this recommendation will be very hard for senior foresters to accept, as no senior man likes to be sent back to school. It is under these men's control however that the service has become something less than mediocre and those that cannot accept the need to rejuvenate the system, and themselves with it, should step aside.

For the reform of the service to work I recommend that it requires a leader who is a respected senior professional forester who has not been too closely associated with the debacle which has occurred over the last five years. I also recommend that our senior and middle level officers should be sent to observe proper forestry practices in the Phillipines or wherever such practices are occurring. 12

##### 5. Consultative Arrangements

I recommend that a system of regular consultation between the controlling National body and the various regional and provincial bodies must be formulated. The aim must be to prepare and then up-date provincial /regional and National Forestry Plans.

These consultations should also be occasions for all agencies involved in forestry to discuss their interrelationships, to review policy and its implementation and to discuss and solve problems in the administration of the National and the provincial Forestry Development Plans and the various work programmes. Questions of staffing, funding and budget allocations should be discussed.

As the new administrative system settles in, and as the new policy and the new plans are set in place and followed, the consultation process should also become a

major factor in in-service training. Officers at all levels should be able to share and learn from each other's experience. They must become occasions where enthusiasm is spread and morale is built up as the participants realise they are building a forestry system which will lead the way in world tropical forestry. Such consultations will need to be under the control of an experienced professional forester who sees this vision and can pass it on. He must have the respect and loyalty of everyone involved.

#### 6. National Forest Development Plan

The National Plan must be designed to incorporate the principles of the National Policy and it must be worked through to provincial and project level. Thus if sustainable yield forest management is to genuinely be the basic platform of national forestry policy then the implications of this need to be worked through and to be reflected clearly in the national plan and in each project.

The National Plan must look to the future of the forest and not stop (as at present) at the date the resource is allocated for exploitation. For each timber area a decision must be made (well in advance of allocation) about future land use. The answer will depend upon a mixture of national, provincial, local, environmental and legal considerations. The decision needs to be made in the light of accurate knowledge of the quantity and quality of the resource in the area and of the total provincial resource.

Many agencies and interests must be involved in the decision (particularly the landowners) and competing alternative land uses must be considered. If it is decided that all or part of the timber area should be

clear felled and put to rubber or some form of cash cropping then that alternative project should be fully prepared, planned, financed and ready to commence before the forestry Authority approves the clearfelling of the forest.

If the future of the land is to be continued use as a forest resource then no exploitation should be allowed until the resource is fully surveyed and the project planned out in full detail. Before the concession is allocated there must have been the fullest possible consultation with landowners, provincial governments and all relevant agencies to work out exactly what the most desirable conditions of exploitation should be. What are the optimum set of conditions that can fairly be demanded of the developer for the benefit of landowners and provincial and national governments. After full knowledge of the particular timber resource is acquired the permissible harvest rate, the minimum size to be cut, the logging and post logging techniques and the method of damage assessment and control all need to be in place before the concession is allocated, because the main aim of the planning operation is to ensure the future of that forest.

The exact nature of the desirable future must be planned and stated. It should be possible to state exactly what the situation will be in ten years time or at any other point in time. It must be possible to state exactly how the sustainable yield principle will work out in relation to this forest.

If the future of the land is to continue under forest then sustainable yield management may be achieved by a modest and carefully controlled harvesting rate supplemented by carefully specified (and controlled)



natural regeneration silvicultural practices. Alternatively (or in addition) it may be achieved by a forest plantation programme of carefully selected species. In purely commercial terms the plantation approach makes a lot of sense but there are many other human and environmental reasons for preserving and enriching the natural forest. If plantations are to be established to ensure the future supply of timber for a forestry industry it must be decided whether they should be established on the site of the former natural forest or elsewhere on (perhaps) a more economically viable site. It must also be decided how the original landowners are to benefit from the loss of their forest and its replacement by a plantation on the same site or elsewhere.

Obviously then, very important matters of policy must be decided and these must be reflected in the National and Provincial Forestry Plans and programmes. Preparing such plans will be a massive task which requires clear vision and persistent co-operative effort. It will require a complete turn around from the current approach of allocating whatever is strongly demanded as soon as documents can be prepared and suitable signatories can be located.

I recommend that no new project should be allocated until the project is firmly placed in the National Plan and until all these matters have been satisfactorily and co-operatively resolved. To be selecting developers (as at present) before disputes between rival landowners claiming the right to be the permit holder are settled, is madness.

#### 7. National Forest Development Programme 1987 - 1991

It seems certain that the large number of new projects planned for allocation in this programme, and

the high maximum cuts allowable, far exceeds the sustainable yield cutting rate on a national basis. Some Department of Forests experts agree and some disagree with that statement. The World Bank team, after a preliminary examination, advised me that the NFDP vastly exceeds the permissible cutting rate. What is certain is that our knowledge of the resource base is so unreliable that we cannot make a reasonable estimate of what the maximum cutting rate (area by area) should be.

I recommend that the NFDP 1987-1991 should be revised drastically downwards.

#### 8. Resource Survey

I recommend that urgent action be taken to make an accurate national forest survey and that outside assistance be sought for this task. Meanwhile I recommend that no future allocation should be made of any area until this knowledge is available and until detailed, project specific, management plans for sustainable yield forestry are in place.

In order to introduce this principle into the present situation as soon as possible it is necessary to review the conditions of existing operations where excessive harvesting rates have already been allowed and to ensure that appropriate conditions are written into any future allocation. In both cases accurate resource data must be available in order to set the appropriate conditions of operation.

#### 9. Existing Operations:

I recommend that ways be worked out to revise the harvesting rate and to reform the logging practices to bring present operations in line with sustainable yield forestry management principles. The present conditions

of permits (where good silvicultural practices and environmental provisions are standard requirements) can be utilised to help achieve this. Use can be made of the Secretary's powers to forbid harvest of particular species and to give directions on various matters. Most companies will be already in gross violation of their permit obligations and could face cancellation if the Minister decided to enforce their conditions. I believe they may be willing to negotiate new cutting rates and reformed logging practices in order to save their permit.

### New allocations

I recommend that accurate surveys must be conducted and area specific forest management conditions must be imposed before any new allocation proceeds. The management conditions must enshrine sustainable yield forestry in ways appropriate for that timber area.

## 10. Monitoring

As shown in various interim reports the present monitoring system has broken down and without an effective system of supervision and control the best policies, plans and laws are meaningless. The companies will ignore them unless the government plays its enforcement role.

This is a wide subject involving the type of forestry service to be established, its staffing and funding, the conditions it is to enforce and many other matters. I offer here only a few comments.

### (a) Funding

I recommend that:

- (1) The basic principle should be "user pays".  
An estimate of the total cost of effective

monitoring should be made and a levy of (say) K2 per m3 should be imposed and paid to a monitoring fund which should go towards funding the monitoring service.

(ii) Any company caught out in serious breach of its conditions, in cheating or in poor logging practices should be classified as a problem company. It should then have to face random inspections at its own expense. This would enable (for instance) helicopter spot checks to be made.

(iii) Performance guarantee. The obligations imposed on a company to carry out infrastructural works or to construct and operate onshore processing facilities should be secured by Bank guarantees which would oblige companies to perform such obligations, in default of which the guarantee could be drawn upon either to perform those obligations or as a penalty for non performance. Furthermore each company should be obliged to provide a bank guarantee which can be drawn upon to provide reimbursement of the costs of random inspections referred to in (a)(ii) above and damage assessments referred to in (f) below. Such a guarantee should be self-replenishing after a drawdown is made.

(iv) Each company should give an irrevocable direction to its bank to pay export duty and royalties as a first charge against moneys received on its letters of credit.

(b) Staff

As previously stated it is essential and I recommend that there be a unified forestry service with sufficient numbers of trained and experienced personnel under unified control to monitor timber operations.

(c) Transport

Monitoring staff without transport are inoperative. I recommend that consideration should be given to equipping the monitoring service with a fleet of small two-stroke offroad motor bikes. This will get them to the site of most operations as effectively as the very expensive four wheel drive vehicles in most situations.

At the other extreme there are occasions when quick and highly effective inspections need to be made by helicopter and there are times when helicopter hire would be very justifiable.

(d) Conditions in Permits and Agreements

I recommend that conditions should be clear and unambiguous without qualifying escape clause. All relevant agencies must be involved in determining the conditions to be imposed to ensure they are practical and enforceable.

(e) Logging practices

I recommend that the Department of Forests finally make up its mind what standard of logging and post logging treatment should be insisted upon. The exact details must be specified (possibly in the Forest Working Plan). There are signs that DOF is now tending towards the FAO approach (see Interim Report No 5). It must be spelled out clearly for the operators and for the forest inspectors and then it must be strictly enforced.

(f) Damage Assessment

I recommend that there should be a post logging inspection as each coup is cut and before the commencement of the next coup. The inspector should have a predetermined check list of damages and should assess and total the damage and then submit the total to the operator's nominated bank, which will pay the damage from its replenishable bank guarantee.

(g) Royalties

As previously discussed, royalties are absurdly low and do not give landowners anything like a fair return for the loss of their resource.

I recommend that the whole concept of royalties needs to be re-thought so that landowners are paid something like the standing value of tree (currently about K32 per m3 - (see Interim Report No 5 pp 20-21).

#### (h) Marketing

The entire marketing system requires adequate and firmly enforced controls from before the tree is even cut, throughout all stages, until the price paid by the end user is safely delivered in PNG to the producer. There is however no such effective system.

Firstly there is no effective and reliable system of accountability for trees felled and logs extracted and the use to which those logs are put.

Methods of storing, retrieving and analysing relevant data are inefficient and out of date and there is almost complete lack of co-operation between the various agencies involved with forestry. For these reasons the necessary exchange of information is not occurring and allocations are being made without the imposition of adequate operating conditions.

A major cause of the problem is, as previously stated, insufficient and inadequate manpower.

I recommend that the lack of manpower and of adequately qualified manpower must be rectified as a matter of urgency. The situation is critical.

I further recommend the acquisition of modern computerised systems. It may be that substantial outside assistance will be required in the short term whilst an appropriately trained permanent national staff is being put in place.

I understand that the World Bank Study Team will be making recommendations and perhaps offering funding in these areas.

#### 11. Continuous Review and Assessment

It is quite clear that various companies have been delaying their responses to the Commission's inquiries in the hope that my Commission would expire and leave them

free to continue with their planned course of misbehaviour. As the life of the Commission was prolonged by a succession of short term extensions, several companies ran out of patience, or credit, and put in motion their next schemes. Some of these have been referred to in this report, some in the update to Interim Report No. 4 (see Vol 1 pp 87-89 and Schedule 5) and some are reported upon in Interim Report No. 7. In the very last days of this Commission I am still receiving requests to investigate new irregularities.

A Commission of Inquiry cannot, in a practical sense, last indefinitely but I am convinced that a system must be devised where continuing company by company reviews are undertaken on a regular periodic basis, and where there is an ability to conduct a limited public and well publicised enquiry into known or suspected malpractices. My experience shows that a well planned, well prepared investigation followed by a quite short public hearing is capable of deeply probing the practices of a company. Many of the Schedules to this Commission's Interim Reports demonstrate this. It is also quite clear to me that companies fear such a probe particularly when their deeds are publicised.

In a number of cases in Interim Reports I have recommended further investigations into a number of matters which this Commission has not had the time or staff to investigate. I am convinced these investigations must be undertaken and they should be referred to the reviewing body which I am recommending.

In Interim Report No 6 I have referred in a number of places to the need for regular periodic reviews of the performance, particularly in marketing, of foreign companies involved in log sales.

I therefore recommend that even though foreign or local entities are involved in longer term projects that (say) each three years each company should be subject to a routine but thorough review. The review should cover all areas of its activities - its business practices, its logging practices and planning, its care for the environment, its accounting for logs taken, its marketing practices. The review of marketing practices should be wide ranging and cover species identification, scaling, grading, product presentation, market diversification, promotion and buyer and price patterns. The review should also cover the company's localisation achievement, its performance of infrastructure obligations, its responsibility to, relationship with and promotion of the interests of local people and, in general terms, it should involve a full assessment of whether it has acted as a good citizen in a manner consistent with the best interests of Papua New Guinea.

If this, rather than an initial one off approval, became the system it would ensure that only beneficial foreign investment continued uninhibited. If a company was found to fall short of the required standards then its participation may either be ended or conditions may be imposed which would require the company to reform its practices or rectify areas of inadequate or unacceptable performance.

Such a system would not, in my view, deter desirable foreign investment provided the review process was fair and seen to be fair. What it would deter is the type of investment which could not withstand such scrutiny.

I further recommend that there be an ongoing ability to publicly examine suspected malpractices, abuses and corruption related to timber on an ad hoc basis.



The very existence of a capacity to publicly examine such matters on a one off basis - whether under the Commissions of Inquiry Act or under specific legislation would be a significant deterrent to those contemplating malpractice.

All that would be needed, in the short term, is for a Judge or senior magistrate to be available for an appropriate short period, as the occasion arises, with a lawyer to assist, a stenographer, recording equipment, a word processor, a photocopier and an administrative clerk together with temporary premises and an appropriate budget.

For any such inquiry appropriate line department staff should also be made available.

The inquiry should be limited to one company or person or area and it would normally be able to be concluded within one to two months after its commencement.

I believe the benefits gained from such a capacity, and its occasional use, would far outweigh the costs involved.

## 12. Controls on Foreign Investment

The systems of controls on foreign investment, whilst theoretically adequate, are in fact not sufficiently effective. I have recommended that the DOF pre-registration system be formalised and strengthened and that there be broad inter agency participation at the level of the Pre-registration Committee.

There is a need to strengthen and improve NIDA evaluation and the vigorous enforcement of the NIDA laws.

The problems identified have involved lack of sufficiently comprehensive and relevant information being sought and lack of sufficient independent verification of information supplied and lack of independent evaluation of foreign applicants.

Again the underlying problems appear to be lack of staff in sufficient numbers with adequate training and lack of funds and facilities.

It is important that PNG thoroughly and critically evaluates foreign applicants for participation in the timber industry to ensure that only worthwhile applicants are allowed to participate. This is particularly the case in marketing. I have also recommended that participation should be made subject to appropriate conditions and that performance, after approval, must be periodically reviewed. There must be a scheme of adequate and appropriate measures available to be imposed upon applicants whose performance is found, on review, to be unsatisfactory.

Again these aspects are discussed in Interim Report No. 6.

### 13. Price Controls

The system of price controls in force until late 1986 was quite ineffective and positively counter productive. Until that time supposed price control and monitoring was based on the Minimum Export Price (MEP) system used to establish proper export value under the Exports (Controls and Valuation) Act.

The elements used to calculate MEP prices were in some respects of dubious value, the assumptions on which the system was based were erroneous and the method by which MEP prices were established was seriously

defective. Revisions were infrequent and the machinery for revisions was unduly cumbersome. As a result MEP prices were historical - lagging behind market movements and were cast at a falsely low level. There was a known margin between MEP price levels and obtainable market price levels and knowledge of the latter was defective. This margin could be further increased, in the absence of monitoring and control of what was loaded for export, by malpractices such as species misidentification, under-measuring and undergrading. Exports were routinely permitted at MEP prices or above.

The scope for profit shifting or transfer pricing was immense and was availed of by the industry generally with substantial resultant losses in foreign currency earnings and revenue from royalties, export taxes and income taxes.

The scope was reduced by FIC's marketing involvement in late 1986. The introduction of shipment by shipment export licences in December 1986 further improved control. When the DOF Marketing Section, with improved knowledge of obtainable market prices, gained through active market involvement, began to disregard MEP when recommending export licence applications and instead, compared the stated price against obtainable market price, the scope for profit shifting or transfer pricing was further reduced.

This new system, whilst it was more effective, still suffered from the earlier defects of lack of monitoring and control of what was in fact loaded, as opposed to what was disclosed, and from a still imperfect knowledge of obtainable market prices. The new system has now become distinctly less effective due to a lack of staff and facilities and dramatic and urgent remedial action is required immediately.

I recommend that:

- (i) The general control systems require immediate attention.
- (ii) The MEP price system should be abandoned.
- (iii) The value of the SEALPA grading rules should be examined and reassessed by experts.
- (iv) A State Marketing Agency, as outlined below, must be urgently established.

14. Form of Exports - Processing

The clear major thrust in the form of timber exports has been to rapidly increase the level of log exports without concern for adequate supplies of processed timber for the domestic market - let alone sufficient to produce a surplus for export. Exports of plywood, veneer, and chopsticks have ceased. Exports of sawn timber have dropped to insignificant levels. Woodchip exports have declined and are on the verge of stopping. Log exports have increased rapidly and are intended to further increase at an accelerated rate.

PNG has become a supplier of unprocessed natural round logs which sustain processing facilities and provide employment in other countries and has not seriously attempted to obtain the benefits which flow from adding value to those resources by processing locally.

With commercial timber resources diminishing globally, PNG has thus shown a lack of concern to obtain the maximum obtainable value from its rich available resources. The stated policy of encouraging local processing to obtain value added benefits has not produced observable results.

I recommend that full effort be made to insist on up to date and efficient local processing - not half-hearted and wasteful production of second rate products.

I recommend that the government should insist on re-processing techniques such as the production of fibre board which will utilise all waste. Operators must put the good logs through their mills - not the rejects. Reject logs should be processed through the particle board mill or chipmill so as to virtually eliminate waste. Logs should be processed into veneer here not overseas.

#### 15. Benefits to landowners

At present, landowners are gaining a maximum of dislocation and alienation in exchange for minimum benefit from the harvesting of their timber. In many instances, landowners regret their decision to support the exploitation of their resource once they have come to know the minimal return that they receive. The current system of royalty payments yields an insufficient return to landowners and the landowners suffer again when illegal transfer pricing activities are practised.

I recommend that Permit and licence conditions must protect the rights of landowners and the government must properly discharge its responsibilities to landowners when operating rights are allocated and contract and permit conditions are set.

The government's haste to make areas available for allocation and its desire to maximise its own returns leave the landowners in a vulnerable and totally unfair position. It is their interests that the government must be primarily concerned to protect. Once again, when the government fails to enforce infrastructure and other conditions of permits and project agreements it is

usually at the direct expense of the landowners as it was they who stood to benefit from the roads, bridges, townships ... etc. which the company has failed to construct.

#### 16. Landowner Preparation

Landowners are disadvantaged from the very beginning and at no stage do they appear to be properly informed or advised. Despite high sounding phrases they remain passive (and later hostile) bystanders while their logs are cut and carried away.

I recommend that leaders of landowning groups must be properly advised as to the effects of logging. They should be shown examples of good practices and instances where the detrimental effects of logging have impacted on entire ways of life. They must be able to understand their rights at all times and must be afforded a real opportunity to be able to enforce their rights when they are breached. It is a situation where extension officers could help prepare landowners by preparing and showing video tapes. The tapes could show good and bad logging operations and on methods of controlling wastage, under measuring, undergrading and other forms of cheating. The various types of agreement should be explained.

#### 17. Leadership Code

The involvement of people covered by the Leadership Code in the improper practices revealed by the Inquiry must be systematically and continually investigated. There can be no doubt that many foreign operators confidently embark on their improper practices because of the security and protection afforded them by their close association with some leaders.

I have recommended that the Leadership Code be extended to cover a wider range of persons and that it be able to be applied notwithstanding that a wrongdoer has ceased to be a leader. A mandatory disqualification from public office should be applied to persons found to have acted improperly. (See above.)

#### 18. Criminal Law

The criminal law does not adequately address modern fraudulent and corrupt practices. Its reform requires careful consideration by a suitable body such as the Law Reform Commission. I recommend that procedures for updating the criminal law regarding public and private corruption be instituted.

#### State Marketing Agency

The performance of FIC and DOF as marketing agent of the State is detailed in Interim Report No. 3.

State Marketing involvement in a wider context and the shortcomings and benefits gained from that involvement is dealt with in detail in Interim Report No. 6 where I have sought to outline the appropriate and necessary aspects of future State involvement.

The need for active State involvement in marketing and the positive effects which can flow from it cannot, in my view, be seriously questioned in light of this Commission's findings.

State involvement by itself, however, is not a sufficient measure and its effectiveness will largely be dependent upon and interrelated with other effective control systems being put in place. I have recommended an independent State Marketing Agency with wide powers and responsibilities over promotion and marketing in the

broadest sense of both those terms. Such an Agency must clearly be free from Government control and from control by the industry but must be responsive to the wishes of the Government of the day and to constructive comments from industry. The Agency must be commercially oriented and must have adequate staff both in terms of numbers and quality. It must also have adequate modern facilities such as telex and facsimile machines, good analytical computers, unrestricted telephones and appropriate accommodation. It must function along commercial lines.

I have made recommendations as to its structure and functions and as to the manner in which it might be financed.

I have also recommended that its assumption of wider roles should be phased in with the initial phase involving abolition of FIC, transferring FIC's assets to the Agency and the immediate assumption of the present functions of FIC and DOF Marketing Section.

In order to begin an immediate, sustained and successful attack on transfer pricing devices it is essential that the control systems require production of destination end documents so that PNG export prices and export documents for each log shipment can be compared against destination end prices and import documents for the same shipment.

Plainly, once the obvious devices are discovered and eliminated those companies which are determined to transfer price will resort to more sophisticated methods of transferring profits which will be more difficult to detect.

These devices will be most easily detected and discouraged if the Government as I have recommended, builds on the good broad relationships which it has with



main importing countries, such as Japan and Korea, and in a spirit of mutual co-operation establishes Government to Government, and through that, Agency to Agency co-operation and exchanges of information.

I recommend that these contacts must be used and the information being collected, should be collated and analysed by a State Marketing Agency. The SMA must then distribute information to line agencies and co ordinate the co-operation between them. With the SMA also using the data which it generates from its own marketing involvement I have every confidence transfer pricing and related abuses can be minimised, if not eliminated, for the distinct benefit of PNG and its people.

I have estimated that even with limited State involvement in 1986 and 1987, PNG was losing up to USD10 million per year in foreign currency earnings and up to USD 3 million per year in company tax and export duty revenue with a further revenue loss from royalties.

All the aspects are dealt with in detail in IR No 6.

#### Distribution of Report

The Commissions of Inquiry Act under which I was commissioned to conduct this Inquiry "in the public welfare" required me to investigate publicly (except in cases where taking evidence in camera was necessary) and to report to the responsible Minister, the Prime Minister.

I have taken the view that public release and publication of this Commission's Interim Reports and Final Report is a matter falling within the province of the Prime Minister and his Departmental staff. It has disappointed me to receive numerous requests for copies of Interim Reports, from a variety of people, who have

found that copies are not readily available. There are already many complaints about the limited availability or non-availability of copies which have already been tabled in Parliament.

This Inquiry has, I believe, created public interest in what has occurred in the forest industry. The Inquiry was commissioned as the subject matter involved matters affecting the public welfare.

In many cases what is reported will permit owners of remaining forest resources to learn from the mistakes of others, to know of the practices of companies and people with whom they may be asked to deal and to learn the pitfalls which exist in forestry exploitation.

I consider that there is a duty to make the material, which the Commission has produced at public expense, widely available and to distribute full copies of all reports not only to the media but to various libraries and other places where copies can be read by any citizen who wishes to read them or parts of them. I thus recommend free distribution of copies of all reports to:

- (a) each provincial Government, NCDIC and Lae City Authority and where that Government or Authority maintains more than one major library one copy for each major library
- (b) the National Library and National Archives
- (c) each major teaching institution including UPNG, UNITECH and the Forestry College as well as each major National High School.
- (d) each Government Department or agency having an involvement with Forestry and which maintains a library including the Departments of Forests, Trade & Industry, Justice, Finance (Customs and Taxation), Provincial Affairs, Agriculture & Livestock, Education, Environment and Conservation, Foreign Affairs, Home Affairs & Youth, Labour & Employment, Police and Works and agencies including Bank of PNG,

Consumer Affairs Bureau, Forest Industries Council, IASER, Institute of PNG Studies, Law Reform Commission, Legal Training Institute, Ombudsman Commission, the National Parliament and the National Court.

- (e) each overseas mission maintained by PNG.

In this way any interested Papua New Guinean will be able to have access to the reports either free or at minimal cost.

I also recommend that adequate copies of all reports be printed and made available for sale.

## CONCLUSION

Mr Prime Minister the twenty volumes which make up this report present a complete coverage of the factual situations I was commissioned to inquire into. They are intended not only to be informative but also to provide a basis for follow up and remedial action. For this reason the reports contain both textual narrative, tables and statistics and photo copies of key primary documents. Where possible I have also included descriptions of the Commission's work methods for the assistance of future inquiries into these aspects of the timber industry.

The situation which is described in these reports is that of a forestry industry out of control. The reasons for this are that the State, which is the constitutionally appointed guardian of the forests, has failed to assert the guiding principles under which this trust is to be administered. It has failed to establish adequate control measures to contain the foreign companies which are exploiting the forests and it has failed to effectively administer such controls as exist.

As a result of these failures on behalf of government foreign investors have been able to completely dominate the timber industry. By using a combination of bribery, "gifts" and other benefits and by making contributions to politicians and political parties the timber companies have made "partners" of Papua New Guinea leaders at national, provincial and local level.

Once in control of a timber area the overriding preoccupation has been to maximise the volume of logs exported with little or no regard to the damage being caused to the forests and the environment in the process.

By taking advantage of the weakness in the control systems the logs are being marketed fraudulently so that an amount ranging between five and ten USD a cubic metre is being transferred offshore causing very substantial loss to the PNG government and to the resource owners.

By encouraging an ever increasing volume of log exports the government has allowed the previously existing local processing industry to be all but destroyed. Such processing as is still occurring is inefficient and incredibly wasteful. The product produced is consequently second rate and uncompetitive.

Our knowledge of the resource base is shamefully lacking and is insufficient to enable calculations of sustainable yield forest management to be made with any degree of certainty. It is however clear that the existing level of harvesting already exceeds the safe level of cutting and that the additional allocations already planned will place the future timber industry in real jeopardy.

The failure to impose appropriate conditions on timber operations and to enforce those which exist has seriously disadvantaged landowners who almost invariably gain unjustly low benefits from the exploitation of their resource.

The message which cries out through these reports is "Slow Down!" I have recommended that sustainable yield management principles be forced into existing agreements and that no further allocation be made until the resource has been accurately assessed and sustainable yield management plans have been drawn up.

For the sake of future generations the mad rush to export logs must be curbed and integrated onshore processing, plantation forestry and proper care and enrichment of natural forests must become our primary focus.

Forestry policy, legislation and administration must be geared to these ends. Foreign investment must be brought under control and ways must be found to bring the illegal offshore funds, from which the bribes and "benefits" are paid, on shore for the benefit of the country and the resource owners.

There are sufficient examples of more responsible timber operations in PNG to show that it is possible to exploit the natural forest in perpetuity following sustainable yield management principles. To do this will require the introduction of integrated onshore processing complexes where waste is reduced to a minimum and value is added onshore. Appropriate silvicultural techniques can be applied to help the natural forests to regenerate and this process should be supplemented by large scale plantation forestry. Large reputable timber companies can be attracted to this concept if security of title can be arranged. Also, in view of the increased global concern over the loss of tropical forests, donor nations and soft loans can be attracted to this concept.

With the help of agencies like the World Bank Papua New Guinea could set in place a system which could be a model of enlightened self perpetuating forestry bringing benefits for all concerned.

This report however shows that PNG forestry is in chaos. The problems, and some of the worst perpetrators, are fully and critically exposed. To create a model forestry system in Papua New Guinea will require enlightened and firm leadership and creative and effective planning and implementation.

It will not be easy but it is possible and there are agencies, such as the World Bank, which are willing to help.

## APPENDIX 1

### COMMISSION OF INQUIRY INTO FORESTRY WORKING PAPER DOCUMENTARY SOURCES OF NATIONAL FORESTRY POLICY

#### INTRODUCTION

To report on what is the National Forestry Policy has proved to be the most difficult task given to this Commission because a coherent and up to date statement of this policy does not exist nor is there anyone presently engaged in Forestry planning or administration who could possibly give an authoritative statement of existing policy. Faced with this vacuum there appeared to be three options open to the Commission and I took all of them.

(a) Report the fact that there is no coherent statement of National Forestry Policy

This I now do most emphatically. After diligent searching I categorically state that there is no clear and up to date authoritative statement of the aims and objectives of National Forestry Policy and of the Strategies necessary to achieve them.



(b) Fill the gap by "mocking-up" a Policy Statement

This involved a study of existing policy source materials which have legislative or executive authority and attempting to "mock up" what such a policy statement would need to look like in order to be reasonably consistent with those written policy source materials.

In order to inject some rationality into a very confusing situation I have attempted to formulate such a policy mock-up.

(c) Study and Report on Defacto Policy

To report on other aspects of my terms of reference required me to study in some detail what decisions were actually being made in the offices of those in authority, what was actually happening in the forests and at the log ponds, what was actually happening in bogus "transfer pricing companies" in Singapore and Hong Kong and what was actually happening in the foreign and domestic banks which handle the finances of the log export trade.

It quickly became apparant that many decisions were being made and practices were occurring which were quite inconsistent with any formulated forestry policy. Many of these decisions and practices were "illegal" in that they were contrary to, or outside, the existing legislation.

Some of these decisions and practices were open, widespread and well known in government circles and have been happening over a long period of time. These practices and recurring decisions are reported on as a type of de facto policy and they heavily influence the conclusions which I have reached.

In order to "mock-up" a statement of National Forestry Policy it is necessary to introduce the policy source materials I have used in their historical context.

#### POLICY SOURCE MATERIALS PRESENTED IN THEIR HISTORICAL

##### CONTEXT

The major sources from which the policy mock-up will be drawn, listed in chronological order are:

1. The Forestry Act Ch. No 216 (derived from the Forestry Ordinance 1936 - 71 of the Territory of Papua and the Forestry Ordinance of the Territory of New Guinea 1936-71 adopted at Independence in Consolidated form).
2. The Forestry Regulations
3. The Forestry (Private Dealings) Act 1971 Ch. No.217

4. The Forest Industries Council Act Ch. No 215
5. The National Forestry Policy 1974 (White Paper)
6. The Constitution of the Independent State of Papua New Guinea 1975
7. Constitutional Amendment No 1 of 1976 - (Provincial Government)
8. Organic Law on Provincial Government 19...
9. Conservation Areas Act (1978) Ch. No. 362
10. The Environmental Contaminants Act (1978) Ch 368
11. The Environmental Planning Act (1978) Ch No 370
12. Revised National Forestry Policy 1979 (White Paper)
13. N.I.D.A Act 19 Ch. No
14. NEC Decision No 33 of 1985 (State Marketing Authority)
15. NEC Decision No of (alteration to distribution of royalties arrangements)
16. Planning and Budgetary Strategy Documents 1986, 1987, 1988 and 1988 - 1992.
17. World Bank Report No 7121 - PNG "Papua New Guinean Policies and Prospects for sustained and Broad Based Economic Growth" April 1988.
18. The Renewable Resources Group Paper 1989-1993

1. FORESTRY ACT Ch. No 216

The Act recognises that forest resource on customary land, which comprises over 90 percent of the total resource, is owned by the customary land owners. It provides a mechanism whereby the government can buy the timber rights from those owners for an agreed price if they are willing to sell. Those rights are defined in Section 1 as:

"the rights to fell, cut, remove and dispose of growing or dead trees, whether standing or fallen and any part of such trees, and any other vegetable growth ..... and in a National Forest or timber rights purchase area includes the right to remove gravel and other road making materials"

To complete the Timber Rights Purchase (TRP) should involve obtaining the signature of every adult member of the land owning group but in practice it is difficult to obtain every signature. Present policy is to consider the purchase completed if 75% of the signatures can be obtained with no more than 25% missing due to absenteeism. (The legality of this approach is doubtful).

The present policy is to pay the landowners 25 percent of the value which it is estimated will be paid as royalties during the functioning of the operation. Royalties are said to be the value of the standing trees but in fact are set at an absurdly low rate (varying from K3 to K5 per cubic metre and somewhat higher for prime species). At present average FOB prices I have calculated that the real value of the standing tree must be USD 30 or more (See I.R. No 5 p 35 et seq).

A nominal sum is paid at the time of purchase and the balance is paid as royalties are actually received. Thus the landowners are given 25 percent of royalties, the State retains 25 percent and the Provincial Government is given 50 percent. This formula has meant that the landowners have received a very small payment compared with the total FOB price of the timber which now averages about K80 per m<sup>3</sup> When spread between the

large numbers of people involved it is a ludicrously small sum and in many areas it has led to a lot of ill feeling. People have now come to realise more fully the money value of the resource that has been sold and the very real non monetary loss they have also suffered because of the damage to their environment and the lost prospects for a future timber industry in their area.

The Forestry Act then allows the Minister to grant permits for enterprises to harvest and sell the timber and to use the gravel to make the necessary roads, loading ramps .... etc. The normal TRP is for a maximum period of 10 years but in gazetted special areas the purchase can be for up to 25 years. The Minister has powers to impose conditions on permits to control such things as felling practices, size or annual harvest, local processing obligations, environmental protection, log export quota and various infrastructure conditons for public benefit (such as Construction of roads and community facilities).

The Act also provides for licences to be issued for harvesting timber on Government land and Leasehold land on similar conditions. It does not however deal with the question of forestry rights on customary land until it comes to the last section which creates the regulation making powers. By Section 34(1) 2)(d) the power is given to regulate:

"the purchase of forest produce from natives by persons other than natives"

On the basis of this rather weak enabling section. Regulations 17 and 18 were introduced which made it obligatory for non natives to obtain a Timber Authority before purchasing forest produce from a native or from an owner of customary land. An Authority could be given to purchase (for domestic use only) rattan (and other products) and up to 40m<sup>3</sup> of timber. A non native who purchases forest produce from a native or owners of customary land "otherwise than in accordance with Regulation 17" is guilty of an offence and subject to a fine of K100.00. It is upon the strength of this outdated regulation that the entire policy of tying up the forests growing on customary land and imposing government controls over their exploitation was based.

By the late 1960s the demands by private entrepreneurs (usually foreign) to gain access to those forests and the demands by customary owners to sell their timber for profit and to have land cleared for cash cropping was intense - especially in New Ireland. The cumbersome procedures whereby the National Minister, advised by his department, endeavours to preside over the TRP system - on a nationwide basis were unable to meet this demand. The national concern was to ensure orderly development in a way which was fair to each province, which safeguarded the future demands of the

domestic market, which protected the interests of the resource owners, and provided associated benefits for local communities, and which managed the resource as a national asset with the potential for supporting future large scale sustainable integrated forestry operations.

The perceived needs of the New Islanders however, supported by their provincial government, national members and business community, was to harvest the resource as soon as possible. They wanted the right to have direct dealings between owners and timber companies which were prepared to pay a higher cash price than that available to customary owners under the TRP system. The higher price would be in return for quick access to the timber, without the delays and onerous and costly conditions which were associated with the National Government's TRP system. As part of the harvesting process a network of logging roads would be constructed some of which, it was hoped could be used later to enable the establishment of cash cropping.

It was in this climate that the Forestry (Private Dealings Act Ch NO 217 was enacted in 1971. It resulted in a series of Local Forest Areas being declared and private dealings being assented to on New Ireland whereby virtually all the remaining accessible timber resources (including those on all the off shore islands) were committed to timber companies. The

harvesting commenced at reckless speed and virtually without government control, as the National Minister and his department failed to avail themselves of the limited opportunities for their moderating influence which the legislation allowed.

#### THE FORESTRY (PRIVATE DEALINGS) ACT CH. NO: 217

The main scheme of this Act is to empower the Minister to declare an area to be a Local Forest Area (L.F.A) after which the owners by custom of any forest within the LFA may sell their timber direct to any person, including non natives. The method of ascertaining the owners, and a requirement for Ministerial approval on certain basic matters relating to the sale or "dealing", are included. (See 1 R No.4 and its appendices for a study of the use of this Act in New Ireland Province and the discussion about exercise of ministerial discretion in Vol 1 pp 35-45. See 1 R No 5 for the application of the Act to Manus Island.

#### Section 4

Any interested person may apply for the Minister to declare an area to be a Local Forest Area. The Minister must first be satisfied that:



"(1) Where the Minister, on application by any interested person and on payment of the prescribed fee, or of his own motion, is satisfied that-

(a). it is proper to do so having regard to-

(i) the interests of the owners by custom of the timber on any land (including their interests in having their land cleared and so enabling agricultural development to take place on the land);

(ii) the national interests; and

(iii) the prospects for the economic exploitation of the timber; and

(b). the area is one suitable for exploitation under this Act.

He shall, by notice in the National Gazette, declare the area to be a Local Forest Area for the purposes of this Act.

(2). The Minister shall grant or refuse an application for the declaration of a given area as a Local Area within three months of the application.

(3) If the Minister refuses an application under Subsection (1) he shall within 21 days of refusing the application, deliver to the applicant in writing, his reasons for doing so.

Considerable pressure is put on the Minister as he is given only three months to grant or refuse the application and the matters he must consider in that time are important. To do his job properly he should really satisfy himself that the owners are all in agreement, that the extent and nature of the resource is known and that the needs of the community in terms of infrastructure development have been ascertained. He should also be considering what national interests might be at stake if this resource is developed and what stress may be put on such things as port and road facilities, customs, police and forestry services. In

deciding whether the area is "one suitable for exploitation under the Act" the Minister should probably be inquiring whether it would be preferable to proceed by way of TRP to enable the Government to negotiate agreement on such things as construction of national highways, schools and hospitals or an obligation to reafforest or develop an agricultural project. For some isolated areas it may well be that the only hope of financing such developments lies in tying the developments to the exploitation of the timber. To miss this opportunity for long term development so that the immediate customary owners can receive (and probably waste) a somewhat higher short term cash payment may be neither in the national or regional interest.

The Minister must balance all these competing factors within a period of three months and if he decides to reject the application for a Local Forest Area Declaration he must give written reasons and be prepared to defend his decision against court action. (Section 8 provides an appeal to the National Court against a refusal to declare an L.F.A.).

The next step in exploiting timber resources under this Act is to obtain Ministerial assent to the dealing between the Customary owners and the Company wishing to harvest the timber. Firstly, the owners who will sign the dealing must be identified. This is, theoretically, to be done by the Prescribed Authority provided for by section 7, usually the Provincial Secretary. In practice it has been common for the Timber Company to ascertain the names of the clans which

own the resource by custom. It also collects the names of those leaders who will be acceptable to the clans as their Agents. This information is then presented to the Prescribed Authority on the appropriate forms all ready for him to issue his certificate and witness the signatures of the Agents. Substantial independent investigation is rarely carried out by the Prescribed Authority into the owners and the Agents who are authorised to sign and receive money on their behalf.

To obtain Ministerial assent to a Dealing firstly requires that it be agreed to by the parties and drawn up and signed. On one side are the customary owners, represented by the authorised Agents, and on the other side is either the Timber Company which intends to log the area, or, sometimes, a so called "land owner company" which hopes to be approved by the Minister as "the company" but which intends to contract the logging and marketing to the Timber Company which has been the prime mover behind the LFA application. In most cases the incorporation of the landowner company was organised by the Timber Company.

The agreement to sell the timbers has no effect until it is assented to by the Minister.

Once the application for assent is lodged the Minister is placed under pressure to assent. He has sixty days to assent or reject and, if the latter, he must provide written reasons within 14 days and be prepared to defend his decision in the National Court on appeal under Section 8.

There are only four reasons allowed for refusal.

- (a). Non compliance with the Act. This has little effect as the Act sets no criteria for these agreements other than that they must relate to timber within LFA.
- (b). The consideration is inequitable: This has been used as a reason to revise the consideration upwards but it's application is limited as the very low Forestry Act royalties are taken to be the minimum value of the Timber concerned.
- (c). Sale involves less than a reasonable proportion of the timber: This has not yet been raised as a problem.
- (d). There is a market for processed timber and the purchaser has no capacity to process it: This could have been a reason to refuse assent perhaps but has not been used.

It can be seen that the only significant opportunity the Minister has to insert a significant degree of control into the LFA situation is to refuse to declare the LFA and then to negotiate conditions into the Dealing which will oblige the Company to voluntarily accept reasonable conditions and a monitoring role for Forestry officers.

#### FOREST INDUSTRIES COUNCIL ACT CH. NO: 215

This Council was reconstituted in 1979 "for the promotion of the interests of the forest industries". Consisting of representatives of the industry and official appointees under an elected Chairman it's powers and functions were stated to be:

Section 19 "General Powers and Functions of the Council"

(1). Subject to this Act and any directions of the Minister the Council may, for the purpose of promoting the development of forest industries in the country-

(a). engage in activities-

- (i) on its own behalf; or
- (ii) in collaboration with any person or authority, that, in the opinion of the Council, are likely to promote forest industries, or to stimulate the use of Papua New Guinea major forest; and

(b). do all things necessary to assist the marketing of major forest products by persons engaged in the logging, sawing, milling or marketing of such products in quantities not greater than 2 36m<sup>3</sup> of log in a financial year; and

(c). formulate, in conjunction with the Department, standards and methods of grading for the marketing of major forest products; and

(d). inquire into and report on such matters relating to forest industries as are referred to it by the Minister, the Forest Industries Association or a recognized association; and

(e). do all things that is required to do by this Act, or that are necessary or convenient to be done by the Council for giving effect to, or for the performance of its functions under, this Act.

(2). Subject to any directions of the Minister, the Council shall exercise its powers and functions under this Act in such manner as, in the opinion of the Council, is in the best interests of forest industries.

(See 1.R. No 3 Sched.1 for a summary of the Forest Industries Council Act)

In the early 1980s The FIC became involved in a five year debate as to whether it should become the State Marketing Agent with a new function aimed at reducing the extent of transfer pricing. How it took on this role in mid 1986 is fully described in Interim Report No.3 and its appendices.

By 1974 the log export industry was sky-rocketing while the intention to establish onshore processing industries was running into some trouble. At this stage it was decided to publish a major statement of National Forestry Policy. Mr G.L. Carson was employed as a consultant through the Commonwealth Fund for Technical Aid to advise on this policy development exercise.

#### THE CARSON REPORT 1974

He examined the Somare Government's Eight Point Development Plan and a Forestry Department paper which purported to translate the eight points into policy objectives for Forestry. He expressed great concern that the existing legislation and forestry strategies were inadequate to protect the forests and to provide for orderly development of the resource for the national benefit in the face of the rapidly increasing demands of the log export trade. He pointed out the disasters which had resulted from these pressures in other countries such as Malaysia, the Phillipines and Indonesia.

He had some wise words to say about control and management of the forest estate and industry:

"Economic forest, especially main timber tracts, is an important part of the wealth of the whole country, and requires to be properly controlled and managed to develop its full economic potential. The object of management is the implementation of the forest policy which should be clearly stated and well-known to all forest officers responsible for management. The management objectives in Papua New Guinea are the controlled exploitation of the existing forest natural asset and its regeneration in order to produce another economic tree crop as soon as possible.

Seeing that the forests are regarded as a renewable national asset and because of the peculiar ownership problems in Papua New Guinea, it is essential that expenditure on regeneration of the forest resource should be the first charge on the sale of that resource".

Carson made very unfavourable comments on the existing legislation. (which has still not been amended). The main points of his criticism were:

- (a) The only management control provided is the T.R.P system under the Forestry Act which is cumbersome and administratively complex.
- (b) The Native Timber Authority system, which was intended to allow the purchase of only small quantities of timber for domestic purposes, was in fact capable of being misused to allow large log export operations to be carried out by "non natives" without any form of management control;
- (c) The Forestry (Private Dealings) Act Ch. 217 which permits private dealings by non natives with customary owners has many deficiencies:
  - (1) no limitation of size of the forest area;
  - (2) no revenue to Government from such exploitation;
  - (3) lack of control over operations other than by agency (sale of timber) agreement;

- (4) inadequate or no reforestation or other development obligations;
- (5) no control over the completeness and format of information to be supplied by the applicant.

Carson was most concerned that this Act undermined the State's ability to plan forestry development as a national goal. He reported:

"That the owners of individual areas should negotiate separate deals on a direct basis, without reference to national forest resource planning, is diametrically opposed to what owners of natural resources throughout the world are trying to achieve by cooperating in their dealings with consumer countries. The concept of the Private Dealings Ordinance in its present form is contrary to the national policy for distribution of wealth from resource rich to resource poor areas, and to co-ordinate economic development.

Under the Private Dealings Ordinance the land owners enjoy short-term benefits vis-a-vis their counterparts under Timber Purchase Rights Agreements; indeed, a stage could be reached where all forests would be so worked, there would be viturally no forest revenue, and the Department would become superfluous in its present form. Government could end up with a situation where it might be cheaper to import timber rather than extract it from the remaining remote and difficult areas.

It is urgent to retrieve the situation before too much damage is done.....

The appropriate solution is for all forest legislation to be incorporated into a single new Ordinance while retaining flexibility in provision for a number of forest management options".

Carson's report concluded by saying :

"In Papua New Guinea there are compelling reasons for proceeding slowly and for resisting any attempts to realise the timber on a once-and-for-all basis.



The Department's hand will be greatly strengthened by a clear statement of policy and new legislation to support it".

In August, one month after the publication of the Carson Report, the 1974 White Paper on Forestry Policy was published and it is clear that departmental officers must have worked closely with Carson during its preparation. It received N.E.C endorsement. It was supplemented but not replaced by a later 1979 document and appears to be therefore, theoretically still in force.

#### **4. NATIONAL FORESTRY POLICY, 1974**

This document purports to be a comprehensive statement of National Forestry Policy objectives expressed in a way which was consistent with the Government's Eight Point Development Plan. Generally it promotes orderly and responsible development of onshore forest industries with the forests being treated as a renewable national resource which should be economically exploited. It required the exploitation however to be properly managed so that the forests will be renewed in the long term interests of the nation and of the local inhabitants of the forests.

The fact that the industry was by then becoming dominated by log exporting enterprises, which had increased from a mere \$88,000 in 1960 to \$11,657,000 in 1974, was made clear in graphs and tables but was not discussed in the body of the report. The place of log exports was thus not really included in the 1974 Policy Document.

The Document listed the initiatives then being taken to encourage local processing at Vanimu, Open Bay, Kumusi and Sagarai/Gadaisu. The Jant Chipmill had just commenced processing the Gogol forest near Madang and the White Paper was very optimistic:

5.8 "There are high prospects that there will be a steady increase in the volume of veneer and sawn timber and woodchip being exported to world markets."

5.9 The policy was still firmly aimed at increasing export revenue and at the same time benefiting local landowners by concentrating on on-shore processing.

"This can best be done by establishing in each of the major forest blocks an integrated operation producing sawn timber, veneer and/or plywood and wood chips. The position can be further improved by prefinishing sawn wood and the processing of chip into pulp. While the larger export oriented business will for some time depend on expatriate management and finance, the Government is concerned with equity and local participation. It will promote opportunities for the forest owners to participate as investors in the Investment Corporation and as contractors and employees in the primary industries and in associated activities e.g. joinery shops, transport operations and other service facilities."

Despite the obvious trend towards a rapid increase in log exports the 1974 policy statement still sought for a balanced approach which would recognise :-

- (a) the legitimate desire of resource owners to benefit from their timber,
- (b) the need to stimulate local processing and associated industries;
- (c) the need for the creation of a permanent forest estate and the protection of the interests of future generations.

The 1974 White Paper set forth the following National-

**Forestry Objectives and Strategies:**

"12.10 The Government desires:

- (a) to have the forest resources of Papua New Guinea managed as a national asset in the interest of the present and future generations of its people;
- (b) to preserve, develop and maintain through reforestation such forest areas as will enable domestic needs to be met as far as it possible and is warranted and will enable full advantage to be taken of export opportunities;
- (c) to accept the need for protection and management of watersheds; control of soil erosion; conservation of animal and plant communities and the use of forests for recreational and other indirect benefits;
- (d) to encourage the development of permanent forest industries and to provide opportunities for the forest owners to become involved in these industries;
- (e) to promote research into forest technology in order to improve the efficiency of forestry industries to reduce imports and increase export earnings and to improve the social and economic benefits to the nation and the forest owners;

- (f) to promote education in all branches of the forest industry and to encourage a better understanding by the people of the value of their forests in both their own and the national interest; and
- (g) to provide the laws, the organisation and funds to manage effectively the country's forests, having regard to overall development policies and forestry's ability to compete successfully with other demands on the nation's resources.

12.11 To effect this policy the Government directs that:

(A) The forest Estate

The Department will work towards the dedication of sufficient land to achieve the productive, protective and ancillary national policy objectives.

In addition to areas managed by the Department, it will encourage and assist in the establishment and proper management of local authority and private forests.

The location of the forest estate will be determined by national needs and may be influenced by

- (a) the requirements of the other land use authorities;
- (b) the requirements of the owners;
- (c) the nature of the resource
- (d) proximity to markets; and
- (e) the needs of existing industries

The Development and management of the forest estates will aim towards the land owners participation and sharing in the benefits obtained without losing sight of the primary objective, efficiency in management.

The Department will provide the Government with clear recommendations on how to establish the necessary forest estate to meet present and future needs of the country, having regard to contemporary social and political pressures. In taken in regard to old timber rights purchases and land purchased for forest development.

A continuing assessment of forest resource will be carried out in order to:

- (a) maintain an up to date record of the available timber resource;
- (b) enable industry to decide the possibilities of development; and
- (c) plan detailed and orderly utilisation and management of forest areas.

(B) Working Plans

The Department will have working plans prepared for the proper development of each forest estate. These plans will take into consideration;

- (a) resource management objectives;
- (b) environmental factors;
- (c) the marketing potential of the timber resources;
- (d) efficiency and cost of logging techniques,
- (e) costs, standards and location of roads
- (f) land use subsequent to logging
- (g) reforestation objectives and cost benefits.

These plans will be sufficiently flexible to meet changing utilisation and marketing patterns, will ensure adequate control of operations at all times, and will be the basis of the future field activities by the Department.

(C) Reforestation

The Department will cooperate with other land use authorities to develop land use plans over all land the subject of forest industry development to determine those areas to be managed as forest. The basic aim will be to see that the forest resources of PNG are maintained and expanded to ensure that the permanent needs of the forest industry are met and the social and economic environment of the people is protected.

In those areas where there is a deficiency of forest crops it will undertake afforestation projects designed to satisfy local needs.

The Department will aim to maximise local participation at all levels and give particular regard to the involvement of the land owners.

(D) Forest Industries

The Department, in co-operation with other Government agencies, will encourage the development of forest industries in accordance with Government investment guidelines. It will encourage the use of locally processed forest products, take an active part in review of tariffs, imports and export regulations and trade agreements, and in other matters that affect the timber industry. It will within the limits of its resources keep the industry informed of the latest scientific, economic and market developments in regard to forest activities and forest products.

Main aims will be:

- (a) to increase as rapidly as possible the production and export of forest products;
- (b) to diversify markets;
- (c) to improve the quality and extend the processing of forest products within the country so increasing the export value and local employment;
- (d) introduce suitable quality control rules particularly in regard to export products;
- (e) to develop a fully integrated forestry industry of industrial complexes working within permanent forest estates;
- (f) to increase employment, business and training opportunities for local people;
- (g) to develop facilities of general use to the community road, wharves, etc.
- (h) to foster the use of local forest products, and the development of local market opportunities;
- (i) to foster the development of minor forest products industry, especially sago, rattan, resins, and biochemicals;
- (j) to develop techniques to improve industry efficiency, especially logging;
- (k) to ensure that returns to the Government are related to current market and cost criteria.

(G) Finance

A basic objective will be to maximise economic returns to the Government. Royalty will be the primary return, but the Department will in its cost/benefit considerations give consideration to other forms of benefits and returns...."

It is significant that the emphasis is on protecting, expanding and managing the forests as a national asset to be maintained for the benefit of present and future generations. It aims for permanent forest industries of industrial complexes working within permanent forest estates and for full local participation. Reafforestation and protection of the environment receive major focus.

At no stage is the question of timber in log form directly mentioned in the 1974 Policy document. Likewise the existence and operation of the Forestry (Private Dealings) Act is ignored as if these two important factors - private dealings by non natives and log exports were too distasteful for the professional foresters who drafted the policy to mention.

## INDEPENDENCE

In 1975-76 the scene changed completely:

Firstly in September 1975 the Constitution of the Independent State of Papua New Guinea was enacted and the country became independent. This affected a revolutionary change in the status of all laws and, although all the former Forestry Legislation was adopted under the Constitution, it was adopted subject to the provisions of the Constitution, including the provisions guaranteeing basic rights (including certain rights (to owners of property. The consequences following from the enactment of the Constitution are profound and far reaching, and should have prompted an immediate re-examination of forestry policy and legislation to see if aspects of it were now contrary to the constitution.

Secondly, by Constitutional Amendment No 1 of 1976 a radical alteration in the political and administrative structure was effected by the introduction of a system of Provincial Government. Under the Organic Law on Provincial Government Forestry was declared to be a concurrent power and many of the functions of the national Minister for Forests and the national D.O.F were transferred under the Organic Law to provincial governments, together with almost all the field staff.



If anything could have provoked the much needed reassessment of National Forestry policy and the revision of the Forestry legislation these two events, Independence and the introduction of Provincial Government, should have achieved it. But the giant slept on and, to this very day, the National Minister, without the benefit of his former field staff, is attempting to administer centralist colonial policies and legislation in a dramatically altered decentralised post-independence situation. Not unexpectedly he is increasingly opposed by an alliance of frustrated and indignant land owners whose resource is being sold too cheaply, provincial governments which resent what they regard as authoritarian interference in the economic development of their province and profit hungry entrepreneurs who resent the delays and lost profit opportunities of having to deal through Waigani.

##### 5. THE CONSTITUTION OF THE INDEPENDENT STATE OF PAPUA NEW GUINEA 1975

The Preamble to the Constitution, under the heading "National Goals and Directive Principles", sets out the basic philosophical, moral, economic and social aims of the new country. These aims and objectives are "non justiciable" but they are to be used as a primary guide when enacting, interpreting and applying legislation and when making administrative decisions.

So far as exploitation of the forests and other natural resources are concerned the words of the Preamble are a mighty clarion call which cannot be ignored.

I present the following excerpts from the National Goals and Directives Principles of the Constitution with brief comments on their applicability to Forestry policy.

## "2. EQUALITY AND PARTICIPATION"

We declare our second goal to be for all citizens to have an equal opportunity to participate in, and benefit from, the development of our country.

WE ACCORDINGLY CALL FOR -

- (1) An equal opportunity for every citizen to take part in the political, economic social, religious and cultural life of the country; and
- (2) the creation of political structures that will enable effective, meaningful participation by our people in that life, and in view of the rich cultural and ethnic diversity of our people for those structures to provide for substantial decentralization of all forms of government activity; and
- (3) every effort to be made to achieve an equitable distribution of incomes and other benefits of development among individuals and throughout the various parts of the country; and
- (6) the maximization of the number of citizens participating in every aspect of development; and
- (7) active steps to be taken to facilitate the organisation and legal recognition of all groups engaging in development activities."

Applying Directive Principle No.2 to forestry it surely calls for a National Forestry Plan which will enable each province to gain from the exploitation of its timber resource. It calls for the government to help uneducated forest owners to participate in and benefit from the exploitation of their resource and not to be left as helpless bystanders while foreign machines devastate their forest with little benefit to themselves. It calls for the central authoritarian role claimed for the National Minister in forestry matters to be re-examined. At the very least it requires full consultation with, and participation by, Provincial Governments in the making of all plans and decisions involving forestry in their province. It calls for effective localisation and training programmes in Timber companies to replace the hundreds of expatriate skilled and semi-skilled workers with PNG citizens, and to progressively localise the management of these companies. To honour the spirit of Directive Principle No.2 would call for the legal recognition of appropriately organised landowner groups and active encouragement for them to participate commercially in the timber operation on their own land and in related business, agricultural and forestry projects in the area.

### "3 NATIONAL SOVEREIGNTY AND SELF RELIANCE"

We declare our third goal to be for Papua New Guinea to be politically and economically independent, and our economy basically self-reliant.

WE ACCORDINGLY CALL FOR -

- (1) our leaders to be committed to these National Goals and Directive Principles, to ensure that their freedom to make decisions is not restricted by obligations to or relationship with others, and to make all of their decisions in the national interest; and
- (4) citizens and government bodies to have control of the bulk of economic enterprise and productions; and
- (5) strict control of foreign investment capital and wise assessment of foreign ideas and values so that these will be subordinate to the goal of national sovereignty and self-reliance, and in particular for the entry of foreign capital to be geared to internal social and economic policies and to the integrity of the Nation and the People; and
- (6) the State to take effective measures to control and actively participate in the national economy, and in particular to control major enterprises engaged in the exploitation of natural resources; and
- (7) economic development to take place primarily by the use of skills and resources available in the country either from citizens or the State and not in dependence on imported skills and resources; and
- (8) the constant recognition of our sovereignty, which must not be undermined by dependence on foreign assistance of any sort, and in particular for no investment, military or foreign-aid agreement or understanding to be entered into that imperils our self-reliance and self-respect, or our commitment to these National Goals and Directive Principles, or that may lead to substantial dependence upon or influence by any country, investor, lender or donor".

To honour Directive Principle No 3 requires that our National and Provincial Ministers and senior bureaucrats do not enter into arrangements with foreign governments or companies which will interfere with their obligation to manage our forests in the national interest.

It requires policies which favour ownership of timber companies by PNG citizens and governmental bodies. It requires diversion of foreign capital in the timber industry away from the simple log export operations towards the more capital intensive local processing and integrated forestry processing and agricultural development projects.

It requires stringent and rigidly enforced conditions on foreign timber companies, to protect the forests and to ensure that the people and the government obtain a fair revenue return from the enterprise. This will of course require effective measures to prevent transfer pricing.

#### "4 NATURAL RESOURCES AND ENVIRONMENT

We declare our fourth goal to be for Papua New Guinea's natural resources and environment to be conserved and used for the collective benefit of us all, and be replenished for the benefit of future generations.

WE ACCORDINGLY CALL FOR -

- (1) wise use to be made of our natural resources and the environment in and on the land or seabed, in the sea, under the land, and in the air, in the interests of our development and in trust for future generations; and
- (2) the conservation and replenishment, for the benefit of ourselves and posterity, of the environment and its sacred, scenic, and historical qualities; and
- (3) all necessary steps to be taken to give adequate protection to our valued birds, animals, fish, insects, plants and trees".

This fourth goal and its directive principles constitutes a direct call for policies of conservation of flora and fauna, promotion of natural regeneration and reafforestation and careful control of all logging operations to protect the forests and all aspects of the physical environment.

"5 PAPUA NEW GUINEAN WAYS

We declare our fifth goal to be to achieve development primarily through the use of Papua New Guinean forms of social, political and economic organization.

WE ACCORDINGLY CALL FOR -

- (1) a fundamental re-orientation of our attitudes and the institutions of government, commerce, education and religion towards Papua New Guinean forms of participation, and consensus, and a continuous renewal of the responsiveness of these institutions to the needs and attitudes of the People; and
- (2) particular emphasis is our economic development to be placed on small-scale artisan, service and business activity; and
- (4) traditional villages and communities to remain as viable units of Papua New Guinean society, and for active steps to be taken to improve their cultural, social, economic and ethical quality."

This goal requires governments, the banks and the law to recognise appropriate land owner groups as units for exploiting forest resources and other associated business activities. It requires perhaps a scaling down of the size of timber operations and active promotion of Papua New

Guinea small businesses in timber rich areas. To preserve traditional communities as viable units in timber project areas, requires finding ways for them to adjust to change and to advantageously utilise royalty and other cash incomes resulting from the project.

#### "BASIC SOCIAL OBLIGATIONS

WE HEREBY DECLARE that all persons in our country have the following basic obligations to themselves and their descendants, to each other, and to the Nation:-

- (d) to protect Papua New Guinea and to safeguard the national wealth, resources and environment in the interests not only of the present generation but also of future generations; "

The lofty ringing tones of this obligation are in stark contrast with the actuality of most timber projects in the country. The timber companies are clearly ignoring these obligations; so too are most landowner groups. While the resource owners are witnessing the destruction of their own timber resources, the main concerns of most of them are centred on the size of the immediate cash payment, the fact that felling is not happening fast enough and that small pockets of commercial timber have inadvertently been left standing or lying in the forest. Most seem to treat their forests as of little value and to have no concern for the future generations. A grass roots educational programme for resource owners is desperately needed and should be offered before the timber rights are purchased, before permits are issued and before contracts are let.

Although "lip service" has been paid towards some of these constitutional goals in the legislation and policy statements now to be examined, it became sadly apparent during the course of this inquiry that none of them have been achieved, or even energetically pursued, in practice.

#### 6. CONSTITUTIONAL AMENDMENT NO 1 OF 1976 AND THE ORGANIC LAW ON PROVINCIAL GOVERNMENT

These enactments introduced the system of Provincial Government. It has a profound effect upon the question of management of the forest estate as a national asset, but so far it has been given little recognition in the formal statements of National Forestry Policy. On the other hand it has completely changed the method of administering the forests, as forestry has been made a concurrent power and control over almost all "field" functions and field staff has been handed to provincial government.

#### 7. REVISED NATIONAL FORESTRY POLICY 1979

By the end of the decade the existing timber enterprises were showing poor performance in the results they disclosed to PNG authorities. Also it was becoming hard to attract overseas investors into projects involving on-shore processing of timber. On the other hand log exports, which had been virtually non-existent until 1962, had shown a steady increase until 1968/69 after which date



they escalated dramatically. By 1973 the annual volume exceeded 600,000m<sup>3</sup>. See graph. Although the 1974 Policy Statement had virtually ignored this trend the publication of a White Paper entitled "Revised National Forestry Policy 1979" showed the government welcoming it with open arms.

The 1979 White Paper itself does little more than provide guidelines within which an increased volume of log exports will be allowed. To find the full formal statement of National Forestry Policy the 1979 document must still be read in conjunction with the 1974 document; which it revised but did not replace. This fact has been consistently overlooked by the DOF which, to the limited extent that it now seems to be following any formal statement of policy at all, treats the 1979 White Paper as standing alone.

Despite the limited "log export" focus of the 1979 Report it nevertheless opened by expressing some regard for the wider aspects of forestry policy: Thus it commences by quoting passages from the Preamble to the Constitution (*National Goals and Directive Principles*) and by a brief reference to the "Eight Aims" and the National Development Strategy". Without further consideration of how these broad principles can be reconciled with the promotion of log exports, which the White Paper then proceeds to advocate it simply states:-

### "1.3 THE CENTRAL CONCERN AND STRUCTURE OF THIS REVISION

The intention of this Policy Revision is to specify guidelines, consistent with foregoing objectives, for investment in the major forest products industry and with particular reference to that section of the industry which is engaged in production of export"

Other aspects of forestry policy, such as village level forestry, integration of forestry and agriculture, research and training, improvement of quality, increased employment, promotion of minor forest products. are specifically put to one side to be dealt with in future budget speeches while the White Paper gets on with the business of encouraging exports, particularly log exports. The need to reconcile national and provincial interests in the newly decentralised political environment was not really addressed.

The document considers in turn the situation of four types of operation and purports to set forth the guidelines which will be applied to each. It is not well set out and some points listed under the heading of one particular type of operation are obviously intended to apply generally to all.

The guidelines of general application, when extracted from partiucular sections and brought together, appear to be:

1. Strict national government control over allocation of concessions and granting of export entitlements.
2. National government will specify guidelines for allocating concessions fairly between various areas and provinces.

3. Monitor log export prices and market projections and fix total log export quotas.
4. There will be a State Marketing Agent to sell some logs directly.
5. Restrict foreign investment to more capital intensive projects (involving woodchip reafforestation ... etc.) and give preference to PNG enterprises when allocating log export quotas for the less capital intensive projects.
6. Log export entitlements will not be issued to operations being financed by a log buyer as part of a sole rights purchase agreement.
7. Forest Management controls -
  - (a) firm control of volume of log exports;
  - (b) approved forest management plan to be basis for government control;
  - (c) standard environment protection clauses to be included in permits and agreements.
8. Department of Forest and Forest Industries Council to expand market promotion overseas
9. The general rule is the enterprise must construct the infrastructure it requires. This is negotiable and in some case the government might assist by constructing facilities and charging for their use or doing so in return for a share of the equity.
10. The government may negotiate the purchase of equity at par in potentially profitable enterprises.
11. To assist the development of PNG enterprises associated with timber operations conditions are imposed on large operations harvesting in excess of 40 000 m3 per year over 10 year permit or longer. Such enterprises must:-
  - (a) adhere to a local business development programme to involve local enterprises tree felling, log extraction and supply of materials.
  - (b) employ a business development officer to assist, and liaise with the Government on business development.
12. All conditions (or revised conditions of agreement and permits will be enforced fully.

### 13. Training and localisation:

- (a) Each negotiated timber concession will include a requirement that it will adhere to an approved training and localisation programme.
- (b) A "Training Grants Scheme" is discussed for possible future implementation.

### 14. State Marketing Agent

A condition is to be inserted in each new or reviewed Permit that up to 25% of the export allowance must be available for sale by, or at the direction of, a State Marketing Agent.

The enterprise will receive no less than the contract Price less reasonable handling charges and marketing Commission.

### 15. Measures to protect log export revenues

- (a) Strict control of volume of log exports by setting national priorities for the allocation of timber permits and log export quotas.
- (b) "minimum guideline prices" will be imposed;
- (c) Marketing agreements and arrangements for sale of logs to be subject to government approval;
- (d) Encourage domestic sales of processed timber but not by imposing tariffs or import quotas which would raise prices.

### 16. Increase log export taxes to 10% FOB price for all "non-processing log export operations". (This 1979 decision has been implemented.

The four types of operation which are given special attention are set out in the White Paper under the following headings:

- 1. Proposals and Guidelines for the Formation and operation of Papua New Guinea Log Exporting Enterprises.
- 2. Guidelines for Enterprises involved in Timber Processing

3. Guidelines for Foreign Enterprises involved in Large Log Exporting operations and not processing within PNG;
4. Guidelines for Foreign Enterprises involved in limited log export/road construction contracts;

Proposals and Guidelines for the Information and Operation of Papua New Guinea Log Exporting Enterprises.

These enterprises came to be known as Forest Development Corporations. The intention behind the proposals was to assist the actual landowners to fully participate and share in the benefits to the timber operation occurring on their land. They were to receive government assistance in their formation and were to be granted rights to harvest and export logs free of most of the onerous conditions which were to be imposed upon "outsiders". The guidelines for these are:

- (1) Assist with finance and advice the formation of PNG owned log exporting enterprises. (Dept. of Commerce (Business Development) and Dept. of Forests to act jointly).
- (2) To spread the benefit more widely, share-holding in PNG log export enterprises will be held by one or a combination of the following groups-
  - . National Government
  - . Provincial Government
  - . People of the Forest Area.
- (3) PNG Log export enterprise to be managed for first 10 years by an approved contract manager.
- (4) PNG Log export enterprise to be freed from "non profitable" infrastructure obligations".
- (5) Early profits to be used to repay loans.

- (6) (a) Follow up land use plan (agriculture or reafforestation) to be drawn up before logging operation is approved and submitted with the log export proposal. But funding will be by national government and it will be managed separately from the log enterprise.
- (b) A land use planning group to be set up within Department of Primary Industry to evaluate and monitor the entire follow up land use project.
- (c) Land for it must be acquired prior to commencement of logging.

Only two Forest Development Corporations were established and neither was successful, Ulabo Timber Company Pty Ltd and Kumusi Timber Company Pty Ltd. Ulabo failed because the resource granted to it was insufficient. Kumusi Timber Company Pty Ltd failed, because of management problems, because of insufficient resource and because of poor planning and inaccessibility of the resources (See 1.R. No 5 app.3). Several others were planned but never eventuated. Subsequently some companies sought to gain some preference in allocation of permit and less onerous conditions by posing as national companies (one of these was Angus PNG Pty Ltd) 1 R. No 2 and others were Wawoi Guavi Timber Co (1R No 5 app 1) and Bruce Tsang's (Companies 1R No 4 app4). Infact they did not fall within the scope of this policy guideline.

## 2. Investment Guidelines for Enterprises Involved in Timber Processing.

The White paper proposed the following guidelines for these enterprises:

1. Firms seeking to invest in timber processing will be assessed on the following criteria:
  - (a) experience with similar processing;
  - (b) record of profitable and efficient processing activities;
  - (c) experience in forest products marketing;
  - (d) financial capacity
  
2. Measures to encourage timber processing:
  - (a) allow more log exports if enterprise has poor access to domestic market for processed product or an inferior resources composition;
  - (b) taxation incentive (set out in some detail);
  - (c) possible reduction in royalties payable;
  - (d) non application of proposed 10% export tax if processing commitment is fulfilled;
  - (e) assistance in technical and managerial training of PNG employees;
  - (f) release from reforestation requirement
  - (g) failure to meet processing commitments may result in -
    - . loss of export tax rebate;
    - . reduction of log export quota
    - . cancellation of permit and recovery of damages;
  
3. Foreign enterprises may be allowed to combine log export and processing within the following guidelines:
  - (a) at least 30% of log harvest must be processed (higher for enterprises with good access to a domestic market or a good resource);
  - (b) processing schedules and planned expansion to be negotiated at the outset;
  - (c) no log exports near a domestic market if forest resources there are limited or in other places if forest resource is too limited to sustain a long run commercial log export operation.

Marketing guidelines for processing enterprises will be the same as for large log exporters set out in Part 3.

So far there have been very few companies attracted by the opportunity to commence a large on-shore processing facility. Mostly it has been a case of companies being attracted to commence a large log exporting enterprise and then being obliged by the government to, reluctantly,

undertake a degree of local processing as part of the price of their log export quota. Jant in the Gogol Forest near Madang is the only significant exception as it was attracted to commence chip milling to supply its parent company in Japan, the Honzu Dulp and Paper group. It was not given a log export quota. (In recent months it has been permitted to export plantation logs).

Other companies which formerly processed timber as the most significant aspect of their enterprise have, since 1974, substantially reduced the processing side in favour of increased log exports. The category includes Ambogo Sawmills, Wewak/Madang Sawmill Company Pty Ltd, and Open Bay Timbers Pty Ltd.

The drop in the total volume of sawn timber being produce continued to fall from 21000 m3 in 1982 to 4000 m3 in 1987. The trend is now being gradually reversed since Vanimo Forest Products mill went into operation in 1987-88.

3. The Guidelines for Foreign Enterprises Involved in Large Log Export Operations and not Processing within Papua New Guinea

The 1979 White Paper provided the following guidelines for large foreign log exporting enterprises



- (1) The basic premise is that such a concession should only be granted for operations which are combined with substantial additional activities such as agro-forestry projects or reafforestation which require large amounts of capital or advanced technology.
- (2) The foreign enterprise must prove it has enough experience, expertise, capital and marketing skill to handle all aspects of the proposed venture.
- (3) Such large scale of log export operations will be restricted to forest areas which:
  - (a) have a large resource which will last until are afforestation plantation is ready for harvesting or until other follow up development is able to sustain economic activity; and
  - (b) where the forest mix is unsuitable for processing, (this limitation is difficult to understand and, apparently, not followed) and
  - (c) where the forest is not required for a nearby domestic market for processed timber (such as Port Moresby, Lae, and Kavieng).
- (4) The large foreign log exporter (not processing) must undertake an activity which:-
  - (a) integrates well with a logging operation; and
  - (b) will sustain economic activity in the timber area on a permanent basis; and
  - (c) together with logging requires a total investment of at least K5 million; and
  - (d) is included as a priority or open activity in the National Investment Priorities Schedule; and
  - (e) otherwise conforms to the policies of the National Government and the Provincial Government concerned.
- (5) Failure to satisfactorily perform the associated projects within the given timetable may result in the imposition of monetary damages as well as curtailment of their permit.
- (6) For all other matters large foreign log exporters will be subject to the same conditions as are imposed on processing enterprises under Part 3 of the White Paper particularly regarding infrastructure, equity, PNG associated enterprise and training and localisation.

- (7) Joint Ventures between a PNG log exporting enterprise and a foreign log exporter may be approved. The foreign company would hold a minority shareholding in such a venture.

When the large log export operations which have actually been established are measured against these guidelines the observer could be excused for believing that the guidelines were prepared for a different country. It became apparent during the course of this inquiry that virtually none of these guidelines are being followed.

4. The Guidelines for Foreign Enterprises Involved in Limited log Export/Road Construction Contracts.

The 1979 White Paper provided the following guidelines for log export/road construction enterprises:

- (1) A log export permit may be granted to an enterprise in exchange for it constructing a priority road.
- (2) It must be capable of building the road to the required standard and within the given timetable.
- (3) Applications will be decided on a tender system and the enterprise requiring the least volume of log exports will be considered the lowest tenderer. But the contract may be allocated without putting to tender to an existing timber enterprise already working in the area.
- (4) The proposed road must be a clear priority road which would not normally be constructed as part of an existing timber operation or within the required time period or at less cost under a normal road construction contract.
- (5) The forest resource must be capable of sustaining the amount of logging required.
- (6) The term of the timber permit will normally be less than 5 years.

- (7) Export tax on logs will be 10% F.O.B price and normal royalties will be paid.
- (8) No infrastructure or other associated conditions will normally be imposed.
- (9) All standard timber permit conditions will apply.
- (10) It is not intended that the log export road construction contract should imply, or lead to the full allocation of the resource to the road making company.
- (11) An initial fixed log quota will be granted to facilitate commencement of road construction. An additional specified log quota will be granted for each kilometre of road completed and approved.

Operations which have constructed roads in exchange for log export quotas pursuant to this guideline include Stettin Bay Lumber Company, Open Bay, Namyang and Leytrak.

#### ENVIRONMENTAL LEGISLATION

At the same time as the Department of Forests was changing its policy direction to promote the log export business, which obviously was having a devastating effect upon forest environment, the Department of Environment and Conservation was preparing legislation which was designed to protect the environment and, if applied strictly, would necessitate a drastic reform of logging practices. A group of environmental Statutes was then enacted in 1978.

## 8. ENVIRONMENTAL PLANNING ACT CH. NO 370

Under this Act the Minister for Conservation and Environment is empowered to interfere dramatically with any project which may have significant environmental implications. Quite obviously therefore it would apply to most large logging operations. He is empowered firstly to publish general guidelines or guidelines specific to a project or type of project, such as forestry. (No forestry guidelines have been published) Under section 4 of the Act he can issue a requisition to the proponent of a project to submit an environmental plan which must be, amongst other things consistent with the National Goals and Directive Principles set out in the Preamble to the Constitution. The Minister may then approve, approve subject to conditions or refuse to approve the plan and it is an offence to proceed without, or contrary to, the terms of his approval. Once the requisition is issued no Authority, such as the Minister for Forests or the Secretary, may issue any Permit, licence etc prior to, or contrary to the terms of, an approval. (See 1R 5 App.4 for discussion about two Environmental Plans approved in Manus Province)

In environmental matters the subservient position of other authorities (such as the Minister or Secretary for Forests) is demonstrated by the fact that they are obliged to refer any project which they know of, which could be constructed as having significant environmental implications, to the Minister for Environment and

Conservation (Section 7) If the clear statement of government policy which is highlighted by this legislation was being followed no major forestry project could possibly be implemented or continued without the environmental implications being fully taken into account. Until very recently these requirements have simply been ignored in allocating forestry resources.

If the Minister refuses to approve the environmental plan the Act provides for the plan, and the Minister's assessment, to be widely published and for representations by persons and authorities to be considered. The Minister's recommendation must then be submitted to the NEC. The NEC can decide the matter immediately or appoint a Board of Inquiry to make further investigations but, in the end, the final decision on the project will be a matter for the NEC.

#### 9. THE ENVIRONMENTAL CONTAMINANTS ACT CH. NO 368

Makes provisions which authorises the Director for Environment and Conservation and the Health Inspector to interfere in any activity that causes or results in any "environmental contaminant". For example sawdust from a sawmill being dumped into a river system or even into the sea.

This Act makes provisions for the Minister for Environment and Conservation to exercise control over the country's water resources through a National Water Board (NWB). Any activity whether mining, petroleum or forestry which affects a "water course" and ultimately the country's water resource must first get a water permit from the NWB prior to engaging in the activity.

#### 10. WATER RESOURCES ACT CH. NO 205

During the next few years the volume of log exports continued to rise dramatically and the volume of timber being locally processed and exported fell steadily.

Nevertheless the thrust of the Government's stated general economic development policy favoured increased on-shore processing, though there was a shortage of detailed implementation strategies.

#### 11. WHITE PAPER ON INDUSTRIAL DEVELOPMENT 1984

stated a clear policy to promote industrial development, particularly rural industrial development based on the processing of natural resources such as timber and aimed mainly at the export market. Large scale foreign investment in such processing was to be encouraged and facilitated. Taxation incentives were to be provided.

Meanwhile something was clearly wrong in the timber industry.

12. NEC DECISION NO 33 OF 1985 - (State Marketing Authority)

The great majority of the timber companies involved regularly disclosed loss returns for PNG taxation purposes and many of them had strong and open links to overseas foreign "related" companies. From the 1960s onwards there was a great deal of discussion about possible transfer pricing which could be occurring in the log export market. As one method of controlling that situation it was suggested that the government should establish a State Marketing Authority to involve itself in some way, and to a limited extent, in the marketing of logs felled by timber companies for export.

After a debate a lasting 5 years as to whether it should be done by the F.I.C the D.O.F or some other body it was eventually decided by NEC decision N:33 of 1985, that the FIC would play the role of the State Marketing Authority, subject to an Agreement to be drawn up and signed by the State and the FIC. The FIC commenced operating before the agreement was signed ( and it was never properly formalised).

In mid 1986 then the FIC commenced exercising the State's option to market up to 25% of a Company's annual log export quota. It did this by way of buying the logs and reselling. The proceeds were then paid to the Company, less a marketing commission deducted by the F.I.C. These marketing activities of the F.I.C. are examined and reported on in great detail in 1R No 3.

#### **LACK OF POLICY DIRECTION**

While the government in various planning documents, was able to produce coherent policies for such sectors as Agriculture and Industrial Development the policy on Forestry appeared to be full of inconsistencies and out of touch with reality.

Despite requests and directions from the NEC the D.O.F failed to finalise a coherent national forestry policy and the long awaited replacement Forestry Legislation never eventuated. Several draft policies have been prepared in the Department in the last few years but were not even submitted to the NEC for consideration. Until late 1988 the only documents with "approved" status compiled since 1979 were those compiled by the Planning branch of the Department of Finance (after consultation with DOF) for budgetary purpose. These disclose detailed plans and strategies for other sectors of the economy, particularly agriculture, but only "motherhood" statements for Forestry



13. PLANNING AND BUDGETARY STRATEGY DOCUMENTS 1986, 1987,  
1988, 1988 - 1992

These documents show that the general government economic policy during recent years has been to increase public investment in the economic sector by at least 15 percent with the main focus being to generate high returns from investment, particularly in export revenue. The proceeds were to be shared fairly between the business enterprises, the government and the resource owners. Forestry potential is always praised but there are no firm proposals. The "motherhood" statements always mention reafforestation and sustained yield at the same time as pressing for economic exploitation without going into specific details.

The 1988 - 1992 document gives the clearest statement the the government's medium term policy is to press for sustained economic growth as the primary concern, even if it must be at the expense of social equality and welfare goals in the short term.

"Papua New Guinea has enormous potential in agriculture, fisheries, forestry and minerals. It is Government's aim to maximise the exploitation of this productive potential in order to achieve four medium-term objectives. These are:

1. The achievement of sustained economic growth;
2. The creation of income-earning opportunities in rural areas;
3. The establishment of fiscal self-reliance; and
4. The reduction of social and economic inequalities

### The Imperative for Economic Growth

The achievement of accelerated economic growth has remained the primary objective of Government since it first took office in November 1985. The 1988 Budget will re-inforce the initiatives taken in 1986 and 1987 to stimulate investment and economic growth.

But Government will not repeat the mistakes of previous governments by compromising its growth objectives to the achievement of subsidiary social goals. The major contribution of economic growth is in generating the internal revenue to finance education, health and other basic services. Government cannot hope to meet the needs of a growing population if the rate of economic growth and internal revenue generation are allowed to stagnate".

These paragraphs reflect the philosophy which led to plans to double the volume of log exports by 1992.

## CHAPTER V

### SECTORAL STRATEGIES

#### A. Economic Sector

##### Sectoral Objectives

The strategy for the sector will focus on providing the resources and policy environment within which the public and private sectors can function efficiently. It will continue to concentrate on:-

- investing in the development of all agricultural, livestock, marine, forest, petroleum and mineral resources in order to expand income generation and employment creation in both the smallholder and private commercial/plantation.
- investing in projects which (a) produce the highest economic return, (b) generate export and import substitution revenues and (c) generate revenues which are sufficient to cover the operating costs of publicly supported investment projects;

- investing in widening the productive base of the economy in order to make it less vulnerable to cyclical movement in world commodity markets and prices.
- stimulating medium-term growth through encouragement of private investment in the commercial and statutory authority sectors, where returns to capital are generally higher, and invest in the smallholder sector to stimulate short-term economic growth and employment creation;
- establishing a fair return on capital investment in all sectors to local land owners, commercial investors and Government; and
- improving existing preferential tax and other incentives to the commercial enterprise sector:
  - . encourage the retention of profits in the economy, for the purpose of investment in the minerals and natural resources sectors;

In these budget papers the objectives of the forestry strategy are to:-

- "develop renewable forestry resources within the limits of sustainable yields while consolidating timber areas so as to improve the monitoring of logging agreements;
- use felled forestry land either for reforestation or for production within the agriculture and livestock sector (agro-forestry);
- promote private investment in import substitution and export industries;
- invest public sector resources in smallholder forestry activities which lead to the expansion of exports and import substitutions with particular reference to reforestation and social/community forestry, as well as wood energy projects; and
- invest in improvements in national extension, planning, training research and monitoring or public project implementation, in order to improve the technical support offered to provincial divisions in the execution of forestry projects.

The key issues that impinge on the forestry sub-sector are stated to be:-

- "the imbalance present in timber resource harvest/exploitation and replacement. It has been estimated that for every log cut, eight cubic metres are taken out while only one cubic metre is replaced;
- weak institutional linkages between other national and provincial departments. While responsibility for some key functions has been delegated to provincial governments, provinces have been unable to carry out these duties; and
- the increase in the annual log cut and hence the workload of the Department of Forests' has increased more rapidly than staff capacity.

Despite the above problems, the Department of Forests performance has been moderate. In 1986 about 10 Timber Rights Purchase (TRP) areas were completed. By the end of 1987 a further 12 TRP areas will have been completed. About 12 timber permits were issued in 1987. On average three forest projects start in any one year.

Under the New Zealand/PNG Reforestation Project the planting target of 510 hectares has now been achieved. In the for localities where it is being implemented, the areas planted are as follows:

Kuriva (Central Province)	25 Hectares
Ulabo (Milne Bay Province)	285 hectares
Madang N.C. (Madang)	160 hectares
Kaut (New Ireland)	<u>40 hectares</u>
total	510 hectares

By the end of December 1987, a further 500 hectares will have been planted under the Forests Plantation Development Programme.

The initiatives for 1988 are stated to include:-

- "amalgamating all activities associated with the rejuvenation of forest resources into the National Reafforestation Project. This will combine the following:-

- . NZ/PNG Reforestation Project
  - . Natural Regeneration of Indigenous Timber Spices
  - . Plantation Development
- centralising all forestry research under one roof with the establishment of the Forest Research Insitutue (FRI) in Lae; and
  - increasing the Department's participation in the LEAD project to ensure that land issues are resolved early and do not impede forestry development. This should also improve PNG's resources inventory.

Measures to be taken by Government include formulating a new National Forestry Policy, together with the relevant legislative changes.

The Department of Forest will investigate the possibility of privatising existing forest plantalons including Wau/Bulolo, Lapegu, Keravat, Brown River, Madang and Waghi Land owner groups adjacent to these plantations will be encouraged to into enter joint venture operations with potential private developers.

Outlined below are the broad details of Government's Public Investment Programme for this agency. Full details on medium term project allocations and the way in which they relate to the 1988 Budget appropriations are provided in Volume III of the Budget documents.

(Table to be inserted here later)

As will shortly be demonstrated these 1986 to 1988 Planning and Strategy documents were approved by the NEC and presented to the National Parliament. Their emphasis is on sustained yield managment, reafforestation small holden development training and research. They are statements of "good ideas". The real situation in that Government expenditure on reafforestation has been little and getting less and the full focus of departmental attention has been directed to doubling the rate of log exports.

In that context the only clear impression of National Forestry Policy which comes from reading these loosely connected statements is that it is wandering somewhere beyond reality.

### THE NAMALIU GOVERNMENT

Since the Namaliu government took office in 1988 two significant policy initiatives have occurred.

#### **NATIONAL FOREST DEVELOPMENT PROGRAMME 1987-1991 (NFDP)**

This pre existing programme was updated and then submitted to and approved by the NEC in 1988. (It is fully discussed in 1R No.4 Vol 1 Sched 1 and the NEC submission and the Programme are set out as attachment 1 to that Schedule). The programme sets a timetable to more than double the size of the existing area of forest allocated for logging allocating over four million additional hectares by 1992.

The NFDP acknowledged that the huge increase in the volume of logs being harvested would impose impossible burdens upon the National and Provincial Forestry services which are already failing to cope with their existing work load. The NFDP called for a massive staff increase in the monitoring section of DOF of 107 employees in 1988-89.

Although no new staff were appointed to the monitoring section, and the DOF Resource Management section's budget was in fact reduced, the NFDP was approved and the allocations are proceeding as planned.

The NFDP is not itself a policy document but the fact that it has been approved and that it was accompanied by an NEC submission which simply gloats over the boost to export earnings which will come from this huge increase in log exports is a clearer indication of government policy than anything that has been written in high sounding words in the last ten years.

The second event of policy significance initiated by the Namaliu government is that drafting instructions for a new Forestry Bill have been approved by NEC and it is believed that preparation of the Bill will proceed.

The drafting instructions did not derive from widespread policy discussions and consultations and were not preceded by the formulation of a National Forestry Policy. Minister Stack has publicly rejected the need for policy formulation to precede the Bill.

**THE RENEWABLE RESOURCES SECTOR - MEDIUM TERM DEVELOPMENT  
STRATEGY 1989-1993**

Prepared to accompany the 1988/89 Budget Papers contains a more detailed attempt to state National Forestry Policy and Strategies. As the document states however the National Forest Policy and its related strategies are "still in the review stage" and merely give indications about what the policy might become.

**"MOCK-UP" STATEMENT OF FORESTRY POLICY**

Having failed to find any clear and coherent statement of the current national forestry policy in the source materials, which have just been presented in their historical context, it was decided to try and "mock - up" such a statement based upon them.

I have attempted to extract the main points and reconcile the apparent inconsistencies and conflicts where possible. It is presented as a coherent set of broad policy objectives with detailed implementation strategies being referred to wherever it has been possible to find reference to them.

**POLICY OBJECTIVE:**

1. **WHILE RECOGNISING CUSTOMARY OWNERSHIP OF FORESTS ON CUSTOMARY LAND ALL FORESTS WILL BE TREATED AS A NATIONAL ASSET TO BE CONTROLLED BY NATIONAL GOVERNMENT**



**Sources:**

Constitution, Organic Law on Provincial Forestry Act, Forestry (Private Dealings) Act, National Forest Policy 1974 Revised National Forestry Policy,

**IMPLEMENTATION STRATEGIES**

- (a) National Forest Minister is given power to control national aspects of forestry policy under Organic Law on Provincial Governments;
- (b) Administration of the TRP system whereby national government buys timber rights from customary owners and reallocates them;
- (c) Prohibition on commercial exploitation by non natives of forests on customary land subject to a limited right of private dealing in areas declared by National Minister to be Local Forest Areas (Forestry (Private Dealings) Act).
- (d) National Minister has sole right to allocate and revoke permits to impose conditions to declare Local Forest Areas and to assent to dealings.

**POLICY OBJECTIVES:**

- 3. DECENTRALISATION OF THE FORESTRY INDUSTRY TO AN EXTENT SUFFICIENT TO SATISFY LEGITIMATE DEMANDS FROM THE PROVINCIAL GOVERNMENTS FOR INVOLVEMENT IN DECISIONS AFFECTING THE SOCIETY, ENVIRONMENT AND ECONOMY OF THE PROVINCE

**Sources:**

Organic Law on Provincial Government, National Forestry Policy 1974 Revised National Forestry Policy 1979

**IMPLEMENTATION STRATEGIES:**

- (a) National Government to assist Provincial Governments to prepare a Provincial Forestry Plan which will then form part of the National Forestry Plan (1979 White Paper).
- (b) Full consultation with the provinces while developing the National Forestry Plan.

- (c) Devolution of field supervision of timber operations, reafforestation, collection of royalties .... etc to the Provincial Governments together with all field staff. (Organic Law on Provincial Government)

#### **POLICY OBJECTIVE:**

PROMOTE THE ORDERLY EXPLOITATION OF THE FOREST RESOURCE WHILE AT THE SAME TIME PROTECTING AND EXPANDING IT FOR THE BENEFIT OF FUTURE GENERATIONS.

#### **Sources:**

Constitution, Environmental Planning Act National Forestry Policy 1974, Revised National Forestry Policy 1979, Planning and Budgetary Strategy Document 1988 - 1992 page 58

#### **IMPLEMENTATION STRATEGIES:**

- (a) Requirement to obtain approval to an Environmental Plan under the Environmental Planning Act for any timber operation which will have a substantial effect upon the environment.
- (b) Environmental Protection Conditions in all Timber Permits
- (c) Regulation's empowered by the Forestry Act make provisions aimed at protecting the environment and promoting sound logging practices
- (d) In 1979 White Paper the National Government accepts responsibility to carry out active reafforestation programmes funded by a reafforestation levy to be imposed on timber operations;
- (e) National Minister to impose strict limits on volume of logs to be harvested and exported. Department of Forests to monitor harvest levels in conjunction with the bureau of Customs (through export licence system) monitor level of exports.
- (f) Promotion of natural regeneration is a standard condition in most timber permits and this is to be monitored by national and provincial forestry officers.
- (g) Permit requirements to obtain approval of a detailed Forest Working Plan before commencement of logging and for it to be updated and reapproved annually.
- (h) Make a continuing assessment of forest resource as an aid to national planning.

- (i) Co-operate with other authorities to prepare land use plans to ensure permanent needs of the Timber industry can be met. (1974 Policy V 2.11 (c))

#### POLICY OBJECTIVE:

- 4. PROMOTE EQUALITY BETWEEN CITIZENS IN THE SHARING OF BENEFITS FROM FORESTRY EXPLOITATION AND STIMULATE THE ACTIVE PARTICIPATION OF PNG CITIZENS IN FORESTRY AND ASSOCIATED ENTERPRISES

#### **Sources:**

Constitution. National Forestry Policy 1974

#### IMPLEMENTATION STRATEGIES:

- (a) The national government to develop a National Forest Management Plan to promote even forestry development in all provinces (1979 White Paper)
- (b) Assist landowners to incorporate themselves and to obtain timber permits (the FDC scheme proposed by the 1979 White Paper).
- (c) Give preference to PNG owned enterprises when allocating timber permits (1979 White Paper)
- (d) Promote local business development in association with major timber projects (1979 White Paper). Enterprises harvesting more than 40,000 m<sup>3</sup> per annum to appoint a Business Development Officer for this purpose.
- (e) Government to provide advisory services for small businesses associated with the timber industry (1979 White Paper)
- (f) Approved Training and Localisation plans to be a condition of N.I.D.A registration and of timber permits. (Labour and Employment Act).

**POLICY OBJECTIVE:**

5. THE GOVERNMENT TO ACTIVELY FIND TECHNIQUES FOR PROMOTING "PAPUA NEW GUINEA WAYS" AND PAPUA NEW GUINEA FORMS OF TRADITIONAL ORGANISATION AND SOCIETY AS AN INTEGRAL PART OF FORESTRY EXPLOITATION.

**Sources:**

Constitution. Goal 5

**IMPLEMENTATION STRATEGIES:**

- (a) Enactment by East Sepik Provincial Government of its Land Mobilisation Legislation (and non disallowance by the National Government)
- (b) Joint PNG/Australian funding for the Wewak Angoram Development Feasibility Study into possibility of developing Agro Forestry projects on registered customary land with the incorporated traditional land owning groups accepted as the developers.
- (c) Encourage permit holders and local contractors to us members of a customary social group to perform service contracts for a timber company (such as grass cutting, security services)
- (d) Assisting customary owners to establish cash crops under company plantation trees planted on customary land (Jant)

**POLICY OBJECTIVE:**

6. STRICT CONTROLS ON FOREIGN INVESTMENT IN THE TIMBER INDUSTRY TO STOP IT ATTAINING A POSITION OF DOMINANCE TO THE EXTENT IT WOULD COMPROMISE PNG'S NATIONAL INTEGRITY.

**Sources:**

Constitution goal 3. National Forestry Policy 1974,  
Revised National Forestry Policy 1979.

**IMPLEMENTATION STRATEGIES:**

- (a) Direct all foreign investment into the capital intensive sector of the timber industry and sectors requiring high levels of technical skill (1979 White Paper).
- (b) Introduction of the D.O.F Pre registration scheme to screen foreigners wishing to become involved in PNG forestry. Block those with insufficient skills, reputation finance and experience.
- (c) Leadership Code - to inhibit PNG leaders from falling under the influence of foreign timber companies by accepting bribes, gifts and favours.
- (d) N.I.D.A. legislation and its enforcement.

**POLICY OBJECTIVE:**

# **7. THE STATE TO BECOME A PARTICIPANT IN MAJOR TIMBER ENTERPRISES**

**Source:**

(Constitution Goal 3) Revised National Forestry Policy 1979.

**IMPLEMENTATION STRATEGIES:**

- (a) The right of the State to take up equity is written into many Timber Permits and Project Agreements and has been acted upon several times.
- (b) State to be a part owner in Forest Development Corporations

**POLICY OBJECTIVE:**

8. TO ENSURE A FAIR RETURN TO LANDOWNERS, THE STATE AND PROVINCIAL GOVERNMENTS FROM TIMBER ENTERPRISES

**Source:**

Planning and Budgetary Strategy Paper 1988 - 1992  
National Forestry Policy 1974

**IMPLEMENTATION STRATEGIES:**

- (a) Imposition of import duties
- (b) Imposition of 10% export duty on log exports
- (c) Normal Company Tax on Profits
- (d) Sharing of royalties between National, and Provincial Governments and the resource owners;
- (e) Operation of the State Marketing Authority (FIC and now DOF) to reduce the scale of transfer pricing. (NEC decision No.);
- (f) Conditions in Permits and approved Agreements insisting on fair market price for PNG timber exports;
- (g) Prohibition of log exports by a buyer under a sole purchase right agreement with the producer (1979 White Paper);
- (h) increase the volume of log export allowance (1979 White Paper);
- (i) Resource owners to receive timber rights purchase money, royalties and other payments in accordance with terms of approved agreements;
- (j) Demotion Grant paid to Provincial Governments based on (forestry) exports.

**POLICY OBJECTIVE:**

9. PROMOTE MEDIUM AND SMALL SCALE FOREST PROCESSING AND ASSOCIATED INDUSTRIES OWNED BY NATIONALS

**Sources:**

White Paper on Industrial Development 1984 Budgetary Planning and Strategy documents 1974 National Forest Policy.

**IMPLEMENTATION STRATEGIES:**

- (a) Business development extension work
- (b) Appointment of Business Development officer as a condition of large timber projects.
- (c) Condition of Timber Permit to promote local business development.

**POLICY OBJECTIVE:**

- 10. DEVELOP LARGE SCALE PERMANENT FOREST INDUSTRIES INTEGRATED INTO A PERMANENT FOREST ESTATE PROCESSING TIMBER AND OTHER FOREST PRODUCTS AND PROMOTE ONSHORE PROCESSING GENERALLY.

**Sources:****IMPLEMENTATION STRATEGIES:**

- (a) create climate for business investor confidence
- (b) remove unnecessary restraints on foreign investment
- (c) carefully select appropriate developers
- (d) grant export duty rebate and increased log export quota as reward for fulfilling local processing conditions in permits and project agreements.

**POLICY OBJECTIVE:****11. INCREASE FOREIGN REVENUE AND SUSTAINED ECONOMIC GROWTH  
BY PROMOTING LOG EXPORTS****Sources:**

1979 National Forestry Policy White Paper  
 1987-1991 Natural Forestry Development Programme.  
 1988 Budgetary Planning and Strategy Documents and  
 Ministerial Directives

**IMPLEMENTATION STRATEGIES:**

- (a) Revised National Forestry Policy 1979 sets guidelines for increased log export for a variety of types of enterprise
- (b) 1988 Budget documents place sustained economic growth as the major priority, even if it means a temporary reduction in other "social" goals such as equalisation of incomes, improved health and education services ....etc
- (c) 1987-1991 NFDP sets timetable for allocating additional forest resources totalling more than 4 million hectares-mainly for log exports

**FANTASY LAND**

It should immediately be clearly stated that there is no official document or combination of documents which purports to set out the current formulated forestry policy objectives and strategies in any such coherent manner.

I have attempted to fill that gap by writing what such a statement of policy would probably look like after careful study of all the materials which I have referred to.



The resulting policy statement is, truly based on those materials, and is probably the sort of statement a Minister would like his staff to prepare for him. He would probably approve of it generally and ask for recommendations for removing some of the apparent inconsistencies.

As a statement of actual policy, as it has been administered over the last ten years though, it is pure fantasy. It has hardly any points of contact with the reality of the PNG timber industry as it has been allowed to develop.

Having made a thorough investigation of that industry the following statements about government policy are far more accurate.

#### **DE FACTO POLICY**

1. The Government no longer puts effective emphasis upon the concept of sustainable, renewable resource management for the benefit of future generations
2. Little effective emphasis is now given to the concept of orderly and balanced forestry exploitation, province by province, under firm national control.

3. There is no effective policy or strategy which comes to grips with decentralization. No policy expresses a way to find a proper balance between national and provincial legitimate interests in resource allocation, revenue collection and supervisory and inspection functions.
4. There is no policy to ensure in practice proper logging techniques and follow-up silviculture practices to stimulate natural regeneration of valuable species. Basic techniques, such as marking trees to be felled, indicating the direction of fall, follow-up damage assessment and post logging silvicultural techniques are not required by national policy.
5. Very little emphasis is now being put on reafforestation plantations or the natural regeneration of forests.
6. The main thrust of forestry policy is to maximise revenue by a startling over emphasis on encouraging log export operations.
7. The encouragement of local processing seems to have been abandoned and there has been a drastic reduction in the production of sawn timber over the last ten years.

8. The effective policy is to allow foreign capital, foreign control and foreign profits to dominate the timber scene to the severe detriment of local landowners who are losing their resource under a permit system which derives from colonial times and, with its full emphasis on central control by the Minister and his department, completely fails to come to grips with the realities of provincial government. On the other hand that Act co-exists with the Forestry (Private Dealings) Act which provides for an alternative system which by passes national departmental control and allows for private exploitation, with no size limits to areas, and few other controls imposed. This Act is now being exploited by alliances of Provincial governments with foreign local businessmen and local landowners with the result that the national department appears to be in real danger of becoming redundant. Recent policy has been to increasingly use this Act by declaring ever larger Local Forest Areas with little thought for forestry planning, the national interest or the true interests of the local landowners.
13. Based on statistics given and comments made at a recent seminar in Lae it seems that the training policy for the timber industry is also in disarray. Based on the declared objectives of the 1974 Policy and some aspects of the Revised Policy, 1979, courses were prepared which train graduates in skills required for timber processing, reafforestation, silviculture and forestry

inspections. The Colleges and Institutions are still turning out men with these qualifications but, as the industry's emphasis is now focused substantially on reckless logging practices to get logs for export there is little demand for their services.

As far as the implementation of the policies to control the effects of increased log exports (which were set out in the "Revised National Forestry Policy 1979") is concerned, the "performance" has been abysmal. Of nineteen stated policy aims only one has been effectively achieved and that was the aim to substantially increase the volume of log exports.