



## **Appendix A - National Interest Statement**

### **AUSTRALIAN GOVERNMENT LOAN TO PAPUA NEW GUINEA FOR US\$30 MILLION: 14 DECEMBER 2000**

#### **Introduction**

This National Interest Statement relating to the 14 December 2000 *Loan Agreement Between Australia and the Independent State Of Papua New Guinea* for the amount of US\$30 million is publicly released and tabled pursuant to the requirements of Sections 8C – 8F of the *International Monetary Agreements Act 1947 (IMAA)*, as amended by the *International Monetary Agreements Amendment Act 1998*.

As amended, *IMAA* specifies the conditions under which Australia may provide a loan (or currency swap) to a country undertaking an economic adjustment program supported by the International Monetary Fund (IMF). It also requires the Treasurer to table a statement indicating the reasons why the loan agreement is in Australia's national interest, along with a description of its nature and terms.

A transaction under *IMAA* provides temporary assistance to the recipient country. It offers balance of payments support to boost market confidence, helps stabilise financial flows across the country's exchange markets and reduces volatility in its exchange rate.

The 14 December 2000 US\$30 million Australian Government loan to Papua New Guinea follows the US\$80 million loan provided by the Australian Government on 21 June 2000. The National Interest Statement relating to this loan was tabled on 28 August and was subject to inquiry and report, under the provisions of *IMAA*, by the Joint Standing Committee on Foreign Affairs, Defence and Trade. The Committee's report, which was tabled on 30 October 2000, supported the execution of the loan.

As noted in the National Interest Statement for the previous loan, the financial assistance of US\$30 million provided by the 14 December loan was publicly announced by the Government in June 2000, following its earlier decision to provide two separate loans in support of the IMF's 14 month Stand-By Arrangement, which commenced in March 2000. The comments provided below on Australia's national interest reflect similar perspectives to those presented in the previous National Interest Statement.

## **Australia's National Interest and the Loan Agreement with Papua New Guinea**

Australia's bilateral relationship with Papua New Guinea, our nearest neighbour, is based on important and abiding historical, political, economic, strategic and social connections. As a friendly and sympathetic neighbour, and as PNG's closest partner in trade and investment, aid support, and defence, Australia has an overriding foreign policy interest in Papua New Guinea's sustainable economic development and stability. The presence of around 7,000 Australians in the country is also of significant interest to Australia.

PNG's status as one of Australia's few former colonial possessions also lends to the relationship a moral dimension that is absent from our other ties. It is in Australia's interests to do what we can to ensure our relationship with PNG is consistent with our objective to be a constructive and responsible participant in the development of our immediate region.

Australia's economic interests in PNG, through trade and investment links, are significant to our own continuing economic performance. PNG is our 11th largest investment destination and 18th largest trading partner. Australian investment in Papua New Guinea was estimated at \$2.7 billion at end June 1999, dominated by mining and petroleum, followed by services. Total bilateral trade was worth around \$2.1 billion in 1999. Were PNG to achieve a greater degree of self-reliance, its current call on Australia's aid budget would diminish in the medium to long term. Moreover, Australian exporters could expect to gain from a sustained increase in PNG's prosperity. Australia's current financial assistance to PNG helps underpin these national goals and assists in building much needed international donor and investor confidence in PNG's future.

Key aspects of the relationship between Australia and Papua New Guinea are encompassed in a number of formal bilateral arrangements, reflecting the strong ties between Australia and Papua New Guinea and the importance Australian places on this relationship. Among these formal arrangements, the Treaty on Development Co-operation covers what is by far the largest of any of Australia's bilateral aid programs. Australia currently provides about \$300 million in aid to Papua New Guinea each year, equivalent to almost half the bilateral aid effort and to a fifth of the total aid program.

By mid-1999, Papua New Guinea was experiencing considerable economic, financial, social and political difficulties. These included significant and worsening macro-economic imbalances, poor governance, and strained relations with Australia and the international donor and investment community. Foreign exchange reserves had dropped to critical levels, the exchange rate had collapsed, inflation was rising, and fiscal excess posed a continuing threat to macro-economic stability.

Economic instability may well be acting as a constraint on PNG's ability to promote itself as a responsible regional player. From a national interest perspective, a greater level of regional engagement on PNG's part could be beneficial in relation to Melanesia, currently the least stable part of Australia's South Pacific neighbourhood. A prosperous, stable PNG could play a useful role in easing current and future tensions within the Melanesian realm.

The Morauta Government came to office in July 1999 dedicated to restoring Papua New Guinea's economic management. It introduced a broad-ranging program of economic and political reform, including measures to restore accountability, confidence and economic stability. The new Government gave priority to re-establishing the integrity of public institutions and to achieving key macro-economic objectives. These included stabilizing the currency, lowering interest rates and inflation, and aligning fiscal policy with the availability of resources.

The PNG Government moved quickly to restore sound relations with Australia and, following a previous period of estrangement, to re-engage with the international financial institutions – the IMF and the World Bank. Engagement with the international financial institutions provides access to substantial financial resources, either directly or indirectly, through triggering additional associated bilateral support, has positive effects on business confidence and private sector capital flows, and makes available to the recipient country a body of experience and expertise in the implementation of economic adjustment programs. We note that since the re-engagement of the IMF and World Bank, bilateral assistance has also been provided to PNG by Japan and the European Union.

The Government places a high priority on supporting the implementation of the Morauta Government's economic and political reform agenda. Australia has provided considerable financial support and, under the aid program, extensive technical assistance to key PNG central economic agencies in support of the adjustment effort. We have encouraged the PNG Government to re-engage constructively with the IMF and the World Bank in the promotion of responsibly managed economic reform.

Australia's financial support for PNG has been carefully calibrated in line with its progress in re-establishing relations with the international financial institutions.

- The US\$80 million Reserve Bank of Australia (RBA) swap of 22 December 1999 was put in place following PNG's initial agreement with the IMF on the basic direction of the reform program.
- This short-term bridging finance was replaced by the US\$80 million (equivalent to A\$133.2 million) Australian Government loan of 21 June, which was executed following PNG's agreement with the IMF and World Bank on the details of the reform agenda.
- The support provided under the 14 December US\$30 million loan is to be provided in three tranches and linked directly to the completion of satisfactory IMF program reviews of the Stand-By Arrangement, conducted approximately quarterly during 2000-01.

Key elements of the IMF program, as set out in its Stand-By Arrangement, include fiscal restraint, maintenance of a tight monetary policy stance, and the introduction of a number of structural reform initiatives. Major reforms under the World Bank's Structural Adjustment Loan focus on privatisation, forestry, the civil service (including measures to build integrity and independence), the financial sector, governance, and health and education service delivery.

The provision of the Australian Government loans to PNG is recognition of the considerable gains made to date by PNG under the leadership of Prime Minister Morauta. Australia's financial support will contribute further to our key national interest objective of supporting the stability and sustainable economic development of Papua New Guinea. It forms a crucial part of the broader economic rescue package that Prime Minister Morauta has developed in concert with the IMF, World Bank and other bilateral donors. PNG's stability, economic growth and prosperity have an important bearing on Australia's national interest. The US\$30 million loan supports our national interest in providing some of the means to underpin PNG's economic reform to help build lasting development.

## **The Nature and Terms of the Loan Agreement with Papua New Guinea**

The parties to the 14 December 2000 US\$30 million *Loan Agreement Between Australia and the Independent State Of Papua New Guinea* are the Commonwealth of Australia, the RBA, the Independent State of Papua New Guinea and the Bank of Papua New Guinea.

The loan, which was publicly announced by the Australian and PNG governments at the time of the June loan, has been provided to supplement the IMF's financial support for PNG's program of economic adjustment, involving a US\$115 million Stand-By Arrangement agreed by the IMF Board in March 2000. The loan contributes to the replenishment of PNG's international reserves, a key financial aggregate under the IMF's Stand-By Arrangement, allows for lower PNG Government debt to the Bank of PNG, and underpins PNG's economic and

governance reform efforts. In so doing, the loan also contributes to a further strengthening of investor and donor confidence in the PNG economy by providing additional assurance to financial markets that PNG's adjustment program has broad international support.

As with the June Agreement, the 14 December Loan Agreement, which has also been prepared by the Australian Government Solicitor, contains standard commercial terms and conditions. To protect the Commonwealth's interests, these include an indemnity clause, early repayment provisions, and a range of representations, warranties and covenants provided by the Government of Papua New Guinea and the Bank of Papua New Guinea. The Agreement is governed under ACT law and comes under the jurisdiction of the Supreme Court of the ACT. Conditions precedent to the loan include that the Treasurer of PNG provided a certificate indicating that the raising of the loan was authorised by the PNG Parliament and that the PNG Solicitor-General provided a legal opinion that the provisions of the Agreement are valid and binding on PNG.

The key terms of the loan are identical to those of the June loan, viz, repayments are to commence 2¼ years from the dates of disbursement, with the repayment schedule spread equally over the ensuing 12 quarters, and interest is payable yearly from the dates of disbursement. Consistent with the Government's previously stated intention in regard to loans under *IMAA*, the terms of the loan more than cover the Commonwealth's cost of funds, thereby not imposing direct costs on the Australian taxpayer and providing scope to earn income to offset risk.

As noted above, the loan is to be disbursed in three equal tranches of US\$10 million linked to the completion of the first three reviews of the Stand-By Arrangement by the IMF Executive Board. The first of the reviews was completed on 13 October 2000, triggering a disbursement of A\$18.9 million (calculated at the prevailing exchange rate at the time of the review), on the execution of the loan on 14 December. The second and third IMF program reviews are currently scheduled to be considered by the IMF Board in January and March 2001. Under the terms of the loan agreement, these tranches will be disbursed immediately after the reviews are completed.

As the loan is classified as an advance, it will have no direct impact on the Commonwealth's fiscal and underlying cash balances, or net debt. Interest income from the loan is also offset by increased debt servicing costs, leaving both balance measures broadly unchanged.

Section 8C of *IMAA* sets out the conditions under which Australian assistance may be provided in support of an IMF program in a recipient country. The Treasurer, on behalf of Australia, may enter into a loan agreement if the IMF requests this assistance and if he is satisfied that at least one other government or organisation has provided, or intends to provide, financial assistance to the recipient country in response to a similar request from the IMF. A further condition of Section 8C is

that the agreement must provide for Australia to be able to require early repayment of the loan in the event of suspension, or premature termination, of the IMF program.

The Loan Agreement entered into with Papua New Guinea complies with these three provisions.

- On 14 April 2000, the Acting Managing Director of the IMF, Mr Stanley Fischer, requested Australia's participation in the financing package for Papua New Guinea in support of the IMF's US\$115 million Stand-By Arrangement (approved by the IMF Board on 29 March). His letter requested Australian support both through the refinancing of the US\$80 million swap, effected by the 21 June loan, and through additional financing assistance of US\$30 million, effected through the 14 December loan.
- On 13 June 2000, the World Bank Board approved a US\$90 million Structural Adjustment Loan for Papua New Guinea, fulfilling earlier advice from the IMF of the World Bank's intention to contribute to meeting PNG's 2000 financing gap.
- Clause 9.1 (a) of the Loan Agreement provides for the Commonwealth to be able to require early repayment of the loan if the IMF suspends, or prematurely terminates, its Stand-By Arrangement.

## Chronology

- 14 July 1999: Morauta Government takes office. Shortly thereafter takes first steps in program of economic and political reform, restores sound relations with Australia, and commences re-engagement with the IMF and World Bank.
- 14 December 1999: Agreement between PNG and the IMF on a draft Letter of Intent ('Memorandum on Economic and Financial Policies of the Government of Papua New Guinea') for PNG to enter a Stand-By Arrangement.
- 22 December 1999: US\$80 million swap between the RBA and the PNG Central Bank.
- 20 March 2000: PNG's Letter of Intent to the IMF sets out its plans for economic and governance reform and requests a 14 month Stand-By Arrangement of US\$115 million.
- 29 March 2000: IMF Executive Board approves the Stand-By Arrangement for PNG.

- 14 April 2000: IMF requests Australian support for the Stand-By Arrangement, through loans of US\$80 million and US\$30 million.
- 13 June 2000: World Bank Executive Board approves US\$90 million Structural Adjustment Loan to PNG.
- 21 June 2000: Execution of US\$80 million (A\$133.2 million) loan from the Commonwealth of Australia to the Independent State of Papua New Guinea. Other parties to the Agreement are the Reserve Bank of Australia and the Bank of Papua New Guinea.
- 28 August 2000: National Interest Statement for the 21 June loan tabled in both Houses of Parliament.
- 13 October 2000: IMF Executive Board approves first program review of the Stand-By Arrangement which, subject to the execution of the Agreement for the Australian loan of US\$30 million (on 14 December), triggers the first US\$10 million tranche of Australian support, valued at A\$18.9 million.
- 30 October 2000: Tabling of the report of the Joint Standing Committee on Foreign Affairs, Defence and Trade into the 21 June US\$80 million loan to PNG.
- 14 December 2000: Execution of US\$30 million loan from the Commonwealth of Australia to the Independent State of Papua New Guinea. Other parties to the Agreement are the Reserve Bank of Australia and the Bank of Papua New Guinea.

