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Amendment to the Second Australian Government Loan to Papua New Guinea

Introduction

1.1 On 7 June 2001 a National Interest Statement (NIS) was tabled in both Houses of the Parliament. The statement related to the 23 March 2001 *Amendment of Loan Agreement Between Australia and the Independent State of Papua New Guinea*, that varied the 14 December 2000 *Loan Agreement Between Australia and the Independent State of Papua New Guinea.*

1.2 Under the provisions of the *International Monetary Agreements Act 1947* (the Act) as amended, the NIS is required to be tabled in the Federal Parliament. The text of the NIS is contained in Appendix A. Furthermore under the Act the NIS, once tabled, stands referred to the Joint Standing Committee on Foreign Affairs, Defence and Trade for inquiry and report within two months of the reference to the Committee. The Act is at Appendix B.

Background to Loans

1.3 The Committee has inquired and reported on two Australian Government loans to Papua New Guinea under section 8(F) of the *International Monetary Agreements Act 1947*. The Act specifies in section 8(E) what the content of an NIS is to include, these being:

(a) a description, in as much detail as practicable, of the nature and terms of the agreement; and

(b) the reasons why the agreement is in Australia's national interest, having regard, in particular, to foreign policy, trade and economic interests.

1.4 The Committee, in inquiring and reporting on the NIS and the Australian Government loan agreement, examines closely whether the agreement is in Australia's national interest. In the case of both the first loan and the second loan the Committee concluded that the agreements were in the national interest.

First Loan

1.5 A NIS for an Australian Government loan of US$80 million to Papua New Guinea (PNG)—equivalent to A$133.2 million—was tabled on 28 August 2000 in both Houses of the Parliament. The loan to which that Statement referred was executed on 21 June 2000. The 28 August 2000 NIS is at Appendix C.

1.6 The parties to the 21 June 2000 *Loan Agreement Between Australia and the Independent State of Papua New Guinea* were the Commonwealth of Australia, the Reserve Bank of Australia, the Independent State of Papua New Guinea and the Bank of Papua New Guinea. As explained in the NIS tabled on 28 August, the loan was provided to supplement assistance from the IMF to PNG's program of economic adjustment, involving a US$115 million Stand-By Arrangement agreed by the IMF Board in March 2000.

1.7 On 30 October 2000, following the conduct of a public inquiry into the NIS, the Committee tabled a short report of its findings. The Committee made a number of recommendations to improve the NIS scrutiny process, but nevertheless supported the execution of the loan.

Second Loan

1.8 In the first NIS tabled in the Federal Parliament on 28 August 2000, the Treasurer stated that the Government had announced in June that year an intention to provide additional financial assistance to PNG of up to US$30 million in three equal tranches. In the second NIS of 14 December 2000, that was tabled on 6 February 2001,[1] the Treasurer again stated that the Government had decided at the time the first loan was announced to provide two separate loans in support of the International Monetary

1 If Parliament is not sitting when the Treasurer releases an NIS, section 8(D) of the Act requires the Statement to be tabled as soon as possible after Parliament next sits.

Fund's 14-month Stand-By Arrangement. This Stand-By Arrangement had commenced in March 2000.[2]

1.9 The second loan, which was executed on 14 December 2000, directly linked provision of the loan funds to the satisfactory completion by PNG of the first three program reviews under the Stand-By Arrangement. The first review was completed on 13 October, and the PNG Government consequently gained immediate access to the funds under the first tranche (equivalent to A$18.9 million) as soon as the second loan was executed.[3]

1.10 The Committee in its report on the second loan noted that the 14 December NIS (see Appendix D) explaining the loan to PNG was, in broad terms, similar to the one tabled previously in relation to the first loan, but with additional explanatory information. In a press release issued on 19 December 2000, the Treasurer announced that the loan contributes to the replenishment of PNG's international reserves, allows for lower PNG Government debt to the Bank of PNG, and underpins the PNG Government's economic reform and its efforts to achieve good governance.

1.11 In tabling its report entitled the *Second Australian Government Loan to Papua New Guinea* in the Federal Parliament on 2 April 2001, the Committee supported the execution of the loan. However the Committee again expressed its concerns about the timing of the NIS and the impact this had on the Committee's ability to examine the loan effectively.

Variation to Second Loan Agreement of 14 December 2000

1.12 On 23 March 2001 the Treasurer announced the early release of the second US$10 million tranche of its US$30 million loan to Papua New Guinea.[4] Under the original agreement the release of the second and third tranches were conditional on the successful completion of the IMF's review of PNG's performance under the Stand-By Arrangement.

2 For further information regarding the Stand-By Arrangement and the World Bank's US$90 million Structural Adjustment Loan, see the first NIS tabled on 28 August 2000, p. 20 (Appendix C), the second NIS dated 14 December 2000, tabled on 6 February 2001, pp. 25-26 (Appendix D).

3 NIS, 14 December 2000, p. 27 (Appendix D). Treasurer's press release No. 115, 19 December 2000. The IMF's second and third program reviews of Papua New Guinea's performance under the Stand-By Arrangement were completed on 23 April 2001.

4 Treasurer's press release No. 018, 23 March 2001, *Loan to PNG: Release of Second Tranche.*

1.13 As the Treasurer stated in his press release:

> The decision to release the second tranche of the loan in advance of the IMF's completion of the second review of its program reflects a desire to assist PNG in addressing its temporary budget financing difficulties resulting from unanticipated delays in the disbursement of external assistance initially expected before the end of 2000. It follows the successful completion of review missions by the IMF and World Bank to Port Moresby earlier this month. These missions noted the continuing progress of Papua New Guinea in implementing its wide-ranging Structural Adjustment Program.[5]

1.14 The Treasury on 12 April 2001 wrote to the Committee advising of a variation to the 14 December loan agreement with PNG. In the letter to the Committee The Treasury said that:

> Following an approach to us by PNG on 15 March, the Treasurer agreed to the early release of the second US$10 million tranche of the US$30 million 14 December loan. PNG sought the early release because it faced an immediate and serious cash flow problem as a result of delays in the release of IMF and World Bank funds and associated bilateral financial assistance, including from Australia. PNG's earlier expectation was that it would receive these funds before the end of 2000. Under the terms of the 14 December Loan Agreement, the second tranche of the loan was scheduled for release following the satisfactory completion of the IMF's second program preview. After lengthy delays, the review is now expected to be considered by the IMF's Executive Board in late April.[6]

1.15 The early release of the second tranche required an amendment to the 14 December loan agreement. This amendment was executed on 23 March 2001 and the funds were then disbursed. The amendment to the December loan agreement was executed by the same original parties namely, the Commonwealth of Australia, the Reserve Bank of Australia, the Independent State of Papua New Guinea and the Bank of Papua New Guinea.

1.16 The Treasury sought advice from the Office of General Counsel on whether, under section 8(D) of the *International Monetary Agreements Act*

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5 See Treasurer's press release No. 018, 23 March 2001, *Loan to PNG: Release of Second Tranche*.

6 Exhibit No. 1.

1947, the amended loan agreement would require the public release and tabling of a further NIS to that tabled on 6 February 2001.

1.17 The advice from the Office of General Counsel was that the amended loan agreement was effectively a new agreement, as the basis on which the second tranche was paid was substantially different from that contemplated in the 14 December loan agreement.[7] Hence a new NIS was required setting out the terms of the 23 March amendment to the 14 December loan agreement, and this was tabled on 7 June 2001.

1.18 Following the release of the second tranche on 23 March, the IMF completed its second and third reviews of Papua New Guinea's performance under the Stand-By Arrangement on 23 April 2001. On the successful completion of the review the Australian Government released the third tranche of US$10 million.

Committee Inquiry

1.19 In line with its recommendation in the Second Australian Government Loan report, the Committee sought a confidential briefing from The Treasury. The Treasury provided this briefing on 7 June 2001 prior to the tabling of the NIS.

1.20 In its second loan report, as with the first report, the Committee examined Australia's national interest and assessed the nature and terms of the loan agreement, concluding that it was in Australia's national interest to provide PNG with the loan of US$30 million.

1.21 The legal technicality precipitated under the Act by the 23 March amendment, and the subsequent early release of the second tranche, has not changed the grounds on which the Committee examined the 14 December loan agreement and gave its support.

1.22 The early release gave the PNG Government access to the second tranche US$10 million one month earlier than would have otherwise been the case.

1.23 The Committee reaffirms the importance of supporting a stable, prosperous and increasingly self-sufficient Papua New Guinea. To do so is clearly in Australia's national interest.

Senator Alan Ferguson
Chairman

7 ibid.

Appendix A - National Interest Statement Tabled 7 June 2001

AMENDMENT OF 23 MARCH 2001 TO THE 14 DECEMBER 2000 AUSTRALIAN GOVERNMENT LOAN TO PAPUA NEW GUINEA

Introduction

This National Interest Statement relates to the 23 March 2001 *Amendment of Loan Agreement Between Australia and the Independent State of Papua New Guinea*, which varied the 14 December 2000 *Loan Agreement Between Australia and the Independent State Of Papua New Guinea.* It is publicly released and tabled pursuant to the requirements of Sections 8C – 8F of the *International Monetary Agreements Act 1947*, as amended by the *International Monetary Agreements Amendment Act 1998.*

The statement provides details of the variation to the 14 December 2000 US$30 million loan and is intended to be read alongside the national interest statement for that loan, which was publicly released on the Treasury web site on 19 December 2000 and tabled on 6 February 2001. The statement for the 14 December loan no longer accurately describes the terms of the loan agreement, as the basis on which the second tranche of the loan was paid is substantially different, following execution of the amendment, from that provided for in the earlier agreement.

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

The 23 March amendment to the 14 December 2000 US$30 million loan agreement was executed by the same parties - the Commonwealth of Australia, the RBA, the Independent State of Papua New Guinea and the Bank of Papua New Guinea.

The 23 March 2001 amendment varied the original loan agreement by providing for the early disbursement of the 2nd US$10 million tranche of the loan. Under the terms of the original agreement, the disbursement of the three US$10 million tranches of the loan were linked to the satisfactory completion of the first three IMF program reviews of its US$115 million Stand-By Arrangement.

The decision to release the 2nd tranche of the loan in advance of the IMF's completion of its 2nd review followed an approach from PNG and reflected a desire to assist it in addressing its temporary budget financing difficulties resulting from unanticipated delays in the disbursement of external assistance initially expected before the end of 2000. Before agreeing to the early release, the Treasurer sought and received assurances from the IMF and World Bank concerning PNG's continuing progress in implementing its structural reform program. We note that, earlier in March, IMF staff had reached agreement with the PNG authorities on a revised Letter of Intent for the Stand-By Arrangement and its extension to incorporate end-June 2001 performance criteria.

The decision to disburse the 2nd tranche of the loan prior to the IMF's approval of its 2nd program review was announced by the Treasurer through a press release on the date of disbursement.

The terms of the amendment to the loan agreement also provided for the early release, at the Treasurer's discretion, of the 3rd US$10 million tranche of the 14 December loan. However, this discretion was not exercised. As noted in the chronology below, the IMF Board approved the 2nd and 3rd program reviews on 23 April 2001, the latter thus triggering the release of the 3rd US$10 million tranche of our loan.

Apart from the above, the key terms and conditions of the 14 December 2000 loan agreement are unchanged (as set out on pp. 3-4 of the National Interest Statement), including in relation to principal and interest repayment schedules and clauses protecting the Commonwealth's interests.

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

The discussion of Australia's national interest provided in the National Interest Statement for the 14 December loan (see pp. 1-3) remains relevant to the amended loan agreement. In summary, the loan contributes to our overriding foreign policy interest in Papua New Guinea's sustainable economic development and stability, by forming a crucial part of a broader financial package supporting the implementation of Prime Minister Morauta's economic and governance reform program. The early release of the 2nd tranche of the loan contributed to the achievement of our national interest objectives by supporting PNG's immediate budgetary and macro-economic stability. Consistent with the principle of aligning our support for PNG's economic reform program with its engagement with the international financial institutions, the 2nd tranche of the loan was disbursed only after assurances were provided by the IMF and World Bank that its programs were on track.

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 1st 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.
- 19 December 2000: Release of 1st US10 million tranche of US$30 million 14 December loan.
- 6 February 2001: National Interest Statement for the 14 December loan tabled in both Houses of Parliament.
- 23 March 2001: Execution of amendment of 14 December 2000 loan agreement authorising immediate disbursement of 2nd US10 million tranche, valued at A$20.2 million.
- 2 April 2001: Tabling of the report of the Joint Standing Committee on Foreign Affairs, Defence and Trade into the 14 December 2000 US$30 million loan to PNG.
- 23 April 2001: IMF Executive Board approves 2nd and 3rd program reviews of the Stand-By Arrangement.
- 24 April 2001: Release of 3rd US10 million tranche of US$30 million 14 December 2000 loan, valued at A$19.8 million.

B

Appendix B - *International Monetary Agreements Act 1947*, as amended

Act No. 5 of 1947, as amended

Consolidated as in force on 22 July 1999

(includes amendments up to Act No. 28 of 1998)

Prepared by the Office of Legislative Drafting,
Attorney-General's Department, Canberra

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An Act to approve of Australia becoming a Member of the International Monetary Fund and of the International Bank for Reconstruction and Development and to make such provisions as are necessary or expedient in relation to Australia's membership of the Fund and Bank, or in relation to Australia's support of the Fund and its programs.

1 Short title

This Act may be cited as the *International Monetary Agreements Act 1947*.

2 Commencement

This Act shall come into operation on the day on which it receives the Royal Assent.

3 Interpretation

(1) In this Act, unless the contrary intention appears:

Bank means the International Bank for Reconstruction and Development referred to in the Bank Agreement.

Bank Agreement means the Articles of Agreement of the International Bank for Reconstruction and Development set out in Schedule 2, as amended in accordance with the resolution of the Board of Governors of that Bank set out in Schedule 3.

Fund means the International Monetary Fund referred to in the Fund Agreement.

Fund Agreement means the Articles of Agreement of the International Monetary Fund set out in Schedule 1.

New Arrangements to Borrow means Decision No. 11428-(97/6), dated 27 January 1997, of the Executive Board of the Fund, a copy of which is set out in Schedule 4.

Reserve Bank means the Reserve Bank of Australia.

special drawing rights means special drawing rights allocated by the Fund under Article XV of the Fund Agreement.

Special Drawing Rights Department means the Special Drawing Rights Department maintained by the Fund under the Fund Agreement.

value, in relation to special drawing rights, means the amount that is the equivalent in the currency of Australia of the value of the rights as fixed under the Fund Agreement.

4 Membership of Australia of the Fund and of the Bank

The membership of Australia of the Fund and of the Bank is approved.

4A Participation in Special Drawing Rights Department of Fund

Participation by Australia in the Special Drawing Rights Department is approved.

5 Reserve Bank to be depository

The Reserve Bank, being the central bank of the Commonwealth of Australia, is hereby designated as the depository in Australia for all the holdings of Australian currency, and for other assets, of the Fund and of the Bank.

5A Transfers to and from Reserve Bank of special drawing rights

(1) The Treasurer may give the Reserve Bank a written direction:

(a) to buy special drawing rights from the Commonwealth for an amount equal to the value of the rights; or

(b) to sell special drawing rights to the Commonwealth for an amount equal to the value of the rights; or

(c) to buy special drawing rights from the governments of other countries, the Fund or other institutions, authorities or persons for an amount equal to:

(i) the value of the rights; or

(ii) an amount that is the equivalent of that value in the currency of a country other than Australia; or

(d) to sell special drawing rights to the governments of other countries, the Fund or other institutions, authorities or persons for an amount equal to:

(i) the value of the rights; or

(ii) an amount that is the equivalent of that value in the currency of a country other than Australia.

(5) An instrument giving directions under subsection (1) may contain such incidental or supplementary directions as the Treasurer thinks necessary.

(6) Amounts from time to time payable by the Commonwealth for special drawing rights sold to it by the Reserve Bank under this section are payable out of the Consolidated Revenue Fund, which is appropriated accordingly.

5B Exemption of special drawing rights from taxation

Special drawing rights, and operations and transactions in relation to special drawing rights, are not liable to taxation under any law of the Commonwealth, of a State or of a Territory.

6 Authority to borrow

(1) The Treasurer may, from time to time, borrow, under the provisions of the *Commonwealth Inscribed Stock Act 1911-1946* or under the provisions of any Act authorizing the issue of Treasury Bills, such amounts as are required to be paid by Australia (not being amounts referred to in section 8 of this Act) by reason of:

(a) its membership of the Fund and of the Bank; or

(b) its obligations under the New Arrangements to Borrow, after that decision becomes effective.

(2) Moneys so borrowed may be issued and applied for the purposes of making the payments specified in subsection (1), and of making payments in redemption of securities issued under section 7.

(3) The provisions of the *National Debt Sinking Fund Act 1923-1945* shall not apply in relation to moneys borrowed under this section.

7 Issue of securities

(1) To the extent to which the Fund or the Bank is prepared to accept from Australia, in place of any payment which Australia is required to make to the Fund or to the Bank, or in substitution for any Australian currency held by the Fund or by the Bank, notes or similar obligations issued by Australia, the Treasurer may, on behalf of Australia, execute and issue to the Fund or to the Bank, as the case may be, securities.

(2) Securities so issued:

(a) shall be payable to the Fund or the Bank, as the case may be;

(b) shall be non-negotiable and non-interest bearing; and

(c) shall be payable at their par value on demand.

(3) Sums payable under any security issued under this section shall be a charge on the Consolidated Revenue Fund.

(4) Where, upon the redemption of any such security, the moneys necessary to redeem the security are not paid out of the proceeds of any loan raised under this Act, the moneys shall be

paid out of the Consolidated Revenue Fund, which is, to the necessary extent, hereby appropriated accordingly.

8 Payment of charges

There shall be payable out of the Consolidated Revenue Fund, which is, to the necessary extent, hereby appropriated accordingly, such amounts as Australia is, from time to time, required to pay to the Fund in pursuance of Section 8 of Article V of the Fund Agreement.

8A Appropriation for purposes of Special Drawing Rights Department

Where the Treasurer is satisfied that an amount should be paid out of the Consolidated Revenue Fund to enable Australia to carry out its obligations as a participant in the Special Drawing Rights Department, he may direct that that amount shall be paid out of the Consolidated Revenue Fund, which is, to the necessary extent, hereby appropriated accordingly.

8B Appropriation for the purposes of the New Arrangements to Borrow

(1) If, after the New Arrangements to Borrow have become effective, the Treasurer is satisfied that an amount should be paid out of the Consolidated Revenue Fund to enable Australia to carry out its obligations under that decision, he or she may direct that that amount be paid out of the Consolidated Revenue Fund.

(2) The Consolidated Revenue Fund is appropriated accordingly.

8C Financial assistance by Australia in support of Fund programs

(1) If:

(a) the Fund requests Australia to provide assistance to another country (the ***recipient country***) in support of a Fund program for the benefit of the recipient country; and

(b) the Treasurer 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 Fund;

then the Treasurer, on behalf of Australia, may enter into an agreement that provides for Australia to lend money to the recipient country or to enter into a currency swap with the recipient country.

(2) An agreement under subsection (1) must provide for Australia to be able to require early repayment in the event of the suspension, or premature termination, of the Fund program.

(3) The Consolidated Revenue Fund is appropriated for the purposes of payments by Australia under, or in connection with:

(a) an agreement made under subsection (1); or

(b) a pre-commencement agreement referred to in subsection (4).

(4) For the purposes of subsection (3), ***pre-commencement agreement*** means an agreement that satisfies the following conditions:

(a) the agreement was entered into on behalf of Australia before the commencement of this section, in response to a request by the Fund for Australia to provide assistance to the Republic of Indonesia or the Republic of Korea (the ***recipient country***) in support of a Fund program for the benefit of the recipient country;

(b) the agreement provides for Australia to lend money to the recipient country or to enter into a currency swap with the recipient country;

(c) the Treasurer 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 Fund;

(d) the agreement provides for Australia to be able to require early repayment in the event of the suspension, or premature termination, of the Fund program.

(5) Payments referred to in subsection (3), and transactions in relation to those payments, are not liable to taxation under any law of the Commonwealth or of a State or Territory.

8D Public release and tabling of national interest statement

(1) The Treasurer is to publicly release and table in each House of the Parliament a national interest statement relating to an agreement entered into by Australia under section 8C as soon as practicable after Australia has entered into the agreement.

(2) If a House of the Parliament is not sitting when the Treasurer publicly releases a national interest statement, he or she is to table the statement in that House of the Parliament as soon as practicable after it next sits.

8E Contents of national interest statement

A national interest statement under section 8D is to include:

(a) a description, in as much detail as practicable, of the nature and terms of the agreement; and

(b) the reasons why the agreement is in Australia's national interest, having regard, in particular, to foreign policy, trade and economic interests.

8F Inquiry and report by Joint Standing Committee on Foreign Affairs, Defence and Trade

A national interest statement tabled in the Parliament under section 8D shall stand referred for inquiry and report within two months of the reference to the Joint Standing Committee on Foreign Affairs, Defence and Trade constituted under resolutions of the Senate and the House of Representatives.

9 Payments from Fund or Bank

Any payment made to Australia by the Fund or by the Bank shall be paid into the Consolidated Revenue Fund.

10 Annual report

As soon as practicable after the end of each financial year the Treasurer shall prepare and cause to be laid before each House of the Parliament a report on the operations of this Act and of the operations, in so far as they relate to Australia, of the Fund Agreement and of the Bank Agreement, during that financial year.

11 Regulations

The Governor-General may make regulations not inconsistent with this Act prescribing all matters which are necessary or convenient to be prescribed for carrying out or giving effect to this Act, the Fund Agreement (other than Article IX) and the Bank Agreement (other than Article VII).

C

Appendix C - National Interest Statement Tabled 28 August 2000

AUSTRALIAN GOVERNMENT LOAN TO PAPUA NEW GUINEA

Introduction

This National Interest Statement relating to the *Loan Agreement Between Australia and the Independent State Of Papua New Guinea* is 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.

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.

Australia’s economic interests in PNG, through trade and investment links, are significant to our own continuing economic development. PNG is our 11th largest investment destination and 18th largest trading partner. Australian investment in Papua New Guinea was estimated at $2.3 billion at end June 1998, dominated by mining and petroleum, followed by services. Total bilateral trade was worth around $2.1 billion in 1999.

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. Amongst 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.

The Morauta Government came to office in July 1999 dedicated to restoring Papua New Guinea’s fortunes. 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 stabilising 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. We have 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 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 A$133.2 million (equivalent to US$80 million) Australian Government loan of 21 June 2000 (*Loan Agreement Between Australia and the Independent State Of Papua New Guinea),* which was executed following PNG's agreement with the IMF and World Bank on the details of the reform agenda.

Key elements of the IMF program, as set out in its Stand-By Arrangement, include an underlying balanced budget for 2000, 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 loan to PNG is recognition of the considerable gains made to date by PNG under the leadership of Prime Minister Morauta. To assist in meeting PNG's exceptional external financing needs over 2000-01, the Government announced in June that it would provide additional financial assistance of up to US$30 million. This assistance will be provided in three tranches and will be linked to satisfactory IMF program reviews of the Stand-By Arrangement during 2000-2001. Consistent with the requirements of *IMAA*, the additional support will be separately reported to Parliament. This financing will contribute further to our key national interest objective of supporting the stability and sustainable economic development of Papua New Guinea.

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

The parties to the 21 June 2000 A$133.2 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 agreement, has been provided to supplement the IMF's assistance to PNG's program of economic adjustment, involving a US$115 million Stand-By Arrangement agreed by the IMF Board in March 2000. The Australian loan provides support to PNG's foreign reserves, 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.

The Australian loan replaces a short-term bridging financial support facility, also equivalent to US$80 million, which was established through a swap between the RBA and the Bank of PNG in December 1999, pending agreement on the IMF's Stand-By Arrangement. The Loan Agreement contains standard commercial terms and conditions, including an indemnity clause, designed to protect the Commonwealth's interests. Under the terms of the loan, repayments are to commence 2¼ years from the date of disbursement, with the repayment schedule spread equally over the ensuing 12 quarters, and interest is payable yearly from the date 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 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 broadly 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 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).
- 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.

D

Appendix D - National Interest Statement Tabled 6 February 2001

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.
- 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.
- 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.