

Papua New Guinea and the relationship with Australia

- 2.1 From an Australian perspective, this Chapter will survey briefly and generally some of the events in Papua New Guinea since it gained independence in 1975, with particular emphasis on the events of the 1990s. This is in preparation for consideration of the circumstances and terms of the loan to PNG from Australia, the subject of this inquiry, in the following Chapter. Chapter 4 includes views on issues in this Chapter from other contributors to this inquiry.
- 2.2 Before addressing these matters, it is appropriate to set out the valuable contribution made to this inquiry by His Excellency Mr Renagi R Lohia CBE, the High Commissioner for PNG.

The PNG High Commissioner's views

- 2.3 Mr Lohia stated that the Government of Sir Mekere Morauta had come to power in July 1999, inheriting an economy that was experiencing severe difficulties. It had been exposed to the full brunt of the Asian economic crisis, had experienced a number of natural disasters and it had suffered from poor governance.¹
- 2.4 This Government set itself a number of objectives to address the problems it faced:
- to stabilise the exchange rate and the financial system;
 - to restore fiscal responsibility;

¹ Material in this section is taken from His Excellency's evidence at the public hearing on 12 September 2000, Transcript, pp. 20-23.

- to rebuild the integrity of state institutions and to ensure more orderly government processes and decision-making;
- to re-establish sensible and productive relations with the rest of the world, and
- to pursue a lasting solution to the conflict on Bougainville.

2.5 His Excellency said that the Government had taken great steps to address all these matters:

- the budget has turned around from a 'massive deficit';
- the exchange rate for the kina has stabilised;
- legislation has been passed for the independence of the Central Bank and its hand strengthened to regulate the financial sector;
- Government spending has been targeted at priority areas and institutional strengthening measures are continuing, and
- the Government has made a significant commitment to resolving the issue on Bougainville.

2.6 He referred to the re-engagement that has taken place with the International Monetary Fund (IMF) and the World Bank, and to a Stand-By Arrangement from the IMF and a loan from the World Bank. The Japanese Bank for International Cooperation also provided a loan to PNG.²

2.7 The Australian loan of \$US80 million was used to support the IMF loan to retire domestic debt. It provided considerable debt servicing relief for the PNG Government, and its effect was to strengthen significantly the PNG Government's financial position. This will boost market confidence, help stabilise foreign exchange markets and assist in the efficient conduct of monetary and fiscal policies.

2.8 His Excellency agreed with the sentiments in the National Interest Statement (NIS) about Australia's foreign policy, trade and economic interests. He drew attention to the close relationship between the two nations, and to the benefit of the assistance from Australia and PNG's other development partners.

2.9 Inflation in PNG is being brought under control, interest rates are beginning to ease and control of fiscal policy is being re-exerted. Business conditions are improving, the financial sector is strengthening and confidence is returning. In consultation with the World Bank, a huge

2 These matters will be addressed partially in this Chapter, and in more detail in Chapter 3.

program of structural reforms has been undertaken to ensure that this recovery is sustained and successful.

- 2.10 The High Commissioner believed that the people of PNG had learnt hard lessons and that, while from outside the country there seemed to be a kind of instability, there was actually a considerable degree of both stability and responsibility.
- 2.11 There will be an election in PNG in 2002, and Mr Lohia expressed the view that the programs now set in place will continue for another five to 10 years to establish a process of growth.

PNG since 1975

- 2.12 PNG gained independence from Australia in September 1975. A recent analysis drew attention to some scepticism at that time about the future of the country, pointing out that in fact PNG had survived its first decade quite well.³
- 2.13 In that period, a number of important initiatives were undertaken, including introduction of a system of provincial government and re-negotiation of the Bougainville Copper Agreement. Economic management and performance were generally sound, and substantial new mining and petroleum prospects were coming on stream. The essentially Westminster Parliamentary system flourished, with constitutional procedures being used to guide the three changes of government between 1972 and 1985.
- 2.14 From the mid-1980s, problems were increasingly evident. Tribal fighting in the Highlands and urban lawlessness were creating social strains and were beginning to have impacts on the economy, on the ability of the Government to deliver services in rural areas and on the ability to maintain law and order.⁴
- 2.15 Such things as the destruction of public infrastructure, low world prices for PNG's exports, poor economic management, growing corruption and politicisation of the public service have all taken their toll. Trouble over land around the copper mine on Bougainville led to closure of that mine in 1990 and to difficulties with the Solomon Islands, PNG's eastern neighbour.

3 Unless specified otherwise, material in this section was drawn from an article by Dr Ron May of the ANU, in *The Canberra Times*, 15 September 2000, p. 11.

4 Transcript, Dr Ron May, ANU, 12 September 2000, p. 38.

- 2.16 Additional factors causing problems for the PNG governments have included the cost of the conflict in Bougainville since 1989, and the declining real value of Australia's development cooperation program. There has also been a deterioration in the capacity to deliver services in rural areas, and to maintain law and order.⁵
- 2.17 The effect of these developments led to the Sandline mercenary affair in 1997, where a previous Government hired mercenaries to solve the situation in Bougainville, and to the formation of a government led by Mr Bill Skate. Dealings with Taiwan by the Skate Government in return for funds, and accusations of corruption, brought to a head concerns about the serious economic and political situation in PNG.⁶
- 2.18 The formation of the Morauta Government in 1999, and the policies it has pursued, have gone some way to arresting what was seen as a downward slide. As mentioned by HE the High Commissioner, re-engagement with international financial institutions was one visible sign of that change. Bilateral support has been given, in the form of the \$US50 million loan from Japan, a \$US10 million loan from China and some grants from the European Community. The Government's economic management has been endorsed by both the World Bank and the Asian Development Bank.⁷

The Morauta Government's program

- 2.19 DFAT assessed the first year in office of the Morauta Government as having brought increased stability and improvement to PNG's political and economic situation. Negotiations also continue towards a peaceful settlement of the situation on Bougainville.⁸
- 2.20 The budget has been stabilised and, as part of reforms to the financial system, the Board of the PNG Banking Corporation (PNGBC) was sacked because of some 'prudential difficulties'. Details of the Stand-By Arrangement with the IMF and other financial arrangements will be given in the following Chapter.⁹

5 Transcript, 12 September 2000: Dr Ron May, ANU, p. 38, Dr Bill Standish, ANU, p. 47, Mr Mark Sewell, Treasury, p. 3.

6 Transcript, Dr Ron May, ANU, 12 September 2000, p. 42.

7 Transcript, Dr Ron May, ANU, 12 September 2000, p. 38.

8 Unless specified otherwise, material in this section was drawn from Transcript, Mr John Oliver, DFAT, 12 September 2000, pp. 4-5. For progress on the situation on Bougainville, see Transcript 12 September 2000, pp. 9-10, and later in this Chapter.

9 Transcript, Mr Mark Sewell, Treasury, 12 September 2000, p. 6.

- 2.21 The Morauta Government has also undertaken significant domestic changes, through a program of privatisation and reforms to the health, education, forestry and financial sectors. Legislative reforms passed through the Parliament have included passage of:
- the Central Bank Act, which tightens lending procedures for the PNGBC and reduces the likelihood of political appointees;
 - the Banking and Financial Institutions Act, which requires financial institutions to comply with international banking standards, and
 - the Privatisation Amendment Act, which clarified the roles of the Privatisation Commission, its managing director and chairman.

Rural Development Program

- 2.22 DFAT noted that the objectives of the Rural Development program (RDP) are to encourage national leaders to assist in identifying, formulating, designing, selecting and actually funding development projects in their electorates. There are two components in the RDP:
- under the PNG Constitution, all Members of Parliament receive 0.5 million kina, to be used in their electorates, and
 - the budget for 2000 allocated 1 million kina for each of the 89 'open' electorates, ie. excluding regional members/governors.¹⁰
- 2.23 With the assistance of the World Bank, the PNG Government has developed strong transparency and accountability guidelines for the funds allocated to open electorates. These guidelines now require members of the PNG Parliament to develop and submit project bids for the allocation of funds to their districts. RDP projects must be consistent with the Five-Year District Development Plan, and must address issues such as community participation and sustainability. The guidelines recommend that about 10 per cent of RDP funds are directly allocated to projects administered by churches. This recognises their crucial role in delivering services in PNG's rural areas.¹¹
- 2.24 The new guidelines include eligible focus areas, and specifically exclude such things as payments of bride prices, travel and political expenses. They stipulate clear criteria for selecting projects, and identify the roles and responsibilities of appraising committees. They also include measures against misappropriation of funds.¹²

10 Submission No 4 from DFAT, p. 3.

11 Submission No 4 from DFAT, p. 3, Transcript, 12 September 2000: Mr John Oliver, DFAT, p. 5.

12 Submission No 4 from DFAT, p. 3.

- 2.25 According to DFAT, the PNG Government has made it clear to the World Bank that it wishes to ensure that the RDP is based on a number of sound principles, including:
- project and applicable entity restrictions;
 - pre- and post-transaction accountability;
 - a secure tendering and payments process;
 - reinforcement of PNG's Public Finances Management Act and its subsidiary Treasury Instructions;
 - clarification of administrative and review roles;
 - use of an external accounting firm to assist in developing a management information system, and
 - approvals, monitoring, reporting, audit, fraud control and training.¹³
- 2.26 DFAT stated that these new guidelines have generally improved the accountability and transparency of the processes of the RDP. While it may have been introduced to try to ensure that funds did reach the community, the IMF and the World Bank insisted that accountability provisions were tightened considerably.¹⁴

Reforms to the electoral process

- 2.27 The Political Parties and Candidates' Integrity Bill has been passed for a first time through the PNG Parliament. This Bill 'vastly' tightens controls on party registrations, and is designed to force nominal independents to join a registered party. It will prevent independents from voting on budgets, voting in no-confidence motions on prime ministers, or on Constitutional changes. It also severely limits the ability of an elected MP to move from one political party to another. Once belonging to a party, a member switching allegiance faces dismissal from Parliament. DFAT believes that this Bill seeks generally to strengthen and regulate political parties in PNG.¹⁵

13 Submission No 4 from DFAT, p. 4.

14 Submission No 4 from DFAT, p. 3, Transcript, 12 September 2000: Mr John Oliver, DFAT, pp. 12-13, Mr Michael Dillon AusAID, p. 14.

15 *The Age*, 31 August 2000, p. 11. Transcript, Dr Bill Standish, ANU, 12 September 2000, pp. 44-47 (*passim*). A second passage through the Parliament, later in 2000, is still required. The Morauta Government is considered further in Chapter 4.

- 2.28 The Australian Agency for International Development (AusAID) noted that further legislation was planned to change PNG's electoral system from 'first past the post' to a limited preferential system of voting.¹⁶
- 2.29 The Australian Government does not under-estimate the difficulties faced by the PNG Government. It has strongly welcomed the latter's reform program and has firmly committed itself to continuing to support those efforts. It is both impressed and encouraged by the progress that this Government has made so far, and is confident that those reforms will be vigorously pursued. Treasury referred to the difficulties of the reform program and to the possibility that progress will probably be slow.¹⁷
- 2.30 As DFAT observed it will take a long time to change the political culture in PNG and the reform program may not bring about that change, even in the next two to five years. It believed that a start had been made and the reforms the Morauta Government has put in place will see the gradual introduction of a greater measure of accountability and transparency. For example, changes to the guidelines for the RDP may bring about a gradual improvement in its administration, and a fairer distribution of resources to communities with needs.¹⁸

Recent concerns

- 2.31 These positive developments have taken place against the background, as DFAT observed, of PNG Government concerns about such issues as:
- the general stability of the nation, given sentiments in favour of autonomy in a number of provinces,¹⁹ and
 - law and order difficulties in the Central Highlands and a number of provinces.²⁰
- 2.32 The seriousness of concerns about the law and order situation in PNG was vividly demonstrated in September 2000. After Independence Day ceremonies, soldiers burnt the headquarters building at the Moem Barracks in Wewak, after the soldiers' canteen was closed early.²¹

16 Transcript, Mr Michael Dillon, AusAID, 20 September 2000, p. 14.

17 Transcript, Mr Mark Sewell, Treasury, 12 September 2000, p. 11.

18 Transcript, Mr John Oliver, DFAT, 12 September 2000, p. 14.

19 See *The Age*, 22 September 2000, p. 6: 'PNG clan wants to form new province', and a PAC report, dated 21 September 2000: 'Highlanders agitate for own PNG province', which reports that disgruntled clans in main Southern Highlands Province seek to form PNG's 20th Province.

20 Transcript, Mr John Oliver, DFAT, 12 September 2000, p. 9.

21 See *The Sunday Canberra Times*, 24 September 2000, p. 8 and *The Courier Mail*, 25 September 2000, p. 9.

- 2.33 A week later, there were clashes between police and members of the PNGDF in Boroko in Port Moresby. It was reported that police fired a machine gun to stop a rampage by soldiers in a shopping centre. The trouble was caused by the shooting by police of a soldier in uniform who had allegedly been involved in an armed robbery. Because there were concerns that soldiers would march on the Parliament, the building was 'under heavy police guard' and the sitting was adjourned for lack of a quorum.²²
- 2.34 Additional details on some aspects of this program are valuable for the indications they provide of the seriousness of the Government's intentions about the changes it has made, or proposes to make.

Privatisation

- 2.35 Treasury noted that five major PNG public entities are scheduled for privatisation:
- PNGBC;
 - Air Niugini
 - Elkom;
 - Telikom, and
 - the Harbours Board.²³
- 2.36 It was expected that a combination of PNG interests and those from outside will take these entities over. While national ownership will probably become minimal, the privatisation program reserves a percentage of equity to be taken up by PNG nationals.
- 2.37 Treasury drew attention to the fact that the history of privatisation in PNG, over the past ten years, has not been good. It acknowledged that the program was ambitious in its breadth and its timings, suggesting that it would be difficult for PNG to find buyers in the time proposed. It drew attention to the fact that, while the process was a matter for PNG, Australian Government agencies were assisting the PNG Government. It also noted that the World Bank is actively seeking purchasers for the entities proposed for privatisation.²⁴

22 See *The Australian*, 26 September 2000, p. 28.

23 Material in this section was drawn from Transcript, Mr Mark Sewell, Treasury, 12 September 2000, pp. 7, 8.

24 Transcript, 12 September 2000: Mr Mark Sewell, Treasury, p. 17, Mr John Oliver, DFAT, p. 18.

Health and education

- 2.38 DFAT believed that the health and education sectors were in particular need of long-term development. The PNG Government is aware that both will need considerable infusions of both human and financial resources, but the nation's economic future depends on the health of its citizens, and on their general level of education.²⁵
- 2.39 DFAT noted that, over the years, both the health and education services in PNG had received 'very large amounts' of Australian funds. A point had been reached where the integrity of these sectors needed to be examined, and the Department suggested that radical restructuring and re-financing are required.²⁶

Forestry

- 2.40 DFAT pointed out that the forestry sector is a major resource for PNG and a source of significant, long-term revenue. It is also particularly vulnerable to over-exploitation. Reform of this sector demanded sustainable development and ensuring that contracts for logging are brought under control. It said that these measures had been one of the focuses of the Morauta Government and of particular concern to the IMF and the World Bank. These bodies will want to see progress on reform of the forestry sector as part of the conditions for continuation of assistance.²⁷
- 2.41 The Committee understands that the PNG Government will be taking appropriate measures to ensure that the major problems that have emerged in the forestry sector are addressed.

Bougainville

- 2.42 PNG has problems on both its western and eastern sides that are not yet resolved: West Papua on one side and the Solomon Islands on the other. Southern Bougainville has strong ethnic and historical links with the Solomons.²⁸
- 2.43 The point has already been made that negotiations to solve the situation on Bougainville are making progress. DFAT noted that, while 'broadly encouraging' developments have been occurring in the negotiations for

25 Transcript, Mr John Oliver, DFAT, 12 September 2000, p. 11.

26 Transcript, Mr John Oliver, DFAT, 12 September 2000, p. 13.

27 Transcript, Mr John Oliver, DFAT, 12 September 2000, pp. 11-12. See *The Australian Financial Review*, 18 September 2000, p. 8.

28 Transcript, 12 September 2000: Mr John Oliver, DFAT, p. 9, Prof Hank Nelson, ANU, p. 49.

some time, it was still possible for things to go wrong, particularly because of developments in the neighbouring Solomon Islands.

- 2.44 During 2000, these negotiations have resulted in 'steady progress' and a number of steps forward: the Loloata Understanding in March and the Gateway Communique in May. DFAT believed that discussions in Rabaul in September 2000 had resulted in another step forward in the process, and that all Parties accept that further work needs to be done. The previous deadline for negotiations to resolve the outstanding issues by 15 September 2000 had been overtaken by the discussions in Rabaul.²⁹
- 2.45 It also believed that one of the encouraging developments was that most Bougainvilleans do not want to go back to war. They want their lives to return to normal, and for economic activity in the Province to resume.³⁰
- 2.46 AusAID pointed out that armed conflict began on Bougainville more than ten years ago, and the infrastructure there has virtually disappeared. Australia's development cooperation program there undertakes things that it would not do anywhere else in the world. Part of what that program tries to do is allocate a substantial volume of assistance to rebuild its economy.³¹
- 2.47 At the same time, this year it has been possible to reduce progressively the size of the Peace Monitoring Group on Bougainville from about 300 people to about 200, with a view to further reductions by the end of the year. As DFAT noted, to ensure that there is minimal psychological impact on the population, any additional reductions will only be made as circumstances and the peace process allow.³²

Australia's development cooperation program with PNG

- 2.48 The 1999 Development Cooperation Treaty with PNG is the largest by far of all Australia's bilateral development cooperation programs. Under this Agreement, Australia undertook to provide \$A1 billion of development cooperation to PNG in a range of programs and areas over three years from the 2000/2001 Financial Year.³³

29 Transcript, 12 September 2000: Mr John Oliver and Mr Bruce Hunt, DFAT, pp. 10, 16-17.

30 Transcript, Mr John Oliver, DFAT, 12 September 2000, pp. 15.

31 Transcript, 12 September 2000: Mr Michael Dillon, AusAID, p. 16, Mr John Oliver, DFAT, p. 15.

32 Transcript, Mr John Oliver, DFAT, 12 September 2000, p. 16.

33 For more information on this Agreement, see Joint Standing Committee on Treaties, *Report 29* (December 1999): Chapter 3, pp. 43-54. The 1999 Treaty replaced one signed in 1989. For more information on the range of treaties between Australia and PNG, see *Australian Treaty List: Bilateral* (as at 31 December 1999), DFAT, pp. 225-227.

- 2.49 Through its development cooperation program, Australia is already providing PNG with technical advisers in a range of areas. Dr May of the ANU suggested that if the Morauta Government is to follow a sensible program of reforms, this program will be needed to address a number of deficiencies in the PNG's administrative capacity, including in the PNG Defence Force (PNGDF).³⁴
- 2.50 Assistance to Bougainville has been provided for a number of years from the allocation to PNG under that Treaty: the Minister has committed \$A100 million to the Province over five years. Because of its situation, the program for Bougainville is more flexible than for other Provinces.³⁵

34 Transcript, 12 September 2000: Mr Michael Dillon, AusAID, p. 7, Dr Ron May, ANU, p. 42.

35 Transcript, Mr Michael Dillon, AusAID, 12 September 2000, p. 16.

