

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

- 2.1 This chapter examines Australia's national interest in the context of the second loan to PNG, and assesses the nature and terms of the loan agreement. Under section 8E of the Act<sup>1</sup>, these aspects are required to be included in the National Interest Statement (NIS) tabled in the Parliament by the Treasurer. As discussed in the previous chapter, the first loan to PNG was executed by a Loan Agreement between Australia and PNG on 21 June 2000, for the amount of US\$80 million. The second loan to PNG was executed on 14 December 2000, for the amount of US\$30 million.
- 2.2 Public release of the NIS for the second loan to PNG occurred via Treasury's Internet website and the Treasurer's press release on 19 December 2000, shortly after the loan was executed. The Treasurer tabled the NIS in both Houses of the Parliament on 6 February 2001, since Parliament was not sitting at the time the second loan was executed.<sup>2</sup>

### **Assessment of the First NIS Tabled in August 2000**

- 2.3 The Joint Standing Committee on Foreign Affairs, Defence and Trade (the Committee) concluded in its previous report, which was tabled on 30 October 2000, that the first NIS was deficient in a number of respects. The Committee considered that only the barest minimum of detail about the terms and conditions of the loan had been provided in the NIS,

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1 *International Monetary Agreements Act 1947*, as amended in 1998.

2 See Appendix A for the text of the NIS dated 14 December 2000.

although it had included a satisfactory amount of information about the IMF's involvement in the PNG Government's reform program.<sup>3</sup>

2.4 With respect to the discussion in the NIS of Australia's national interest, the Committee concluded that inadequate explanation had been provided of the reasons why executing the loan had been in the national interest. In a submission presented after appearing at the public hearing in September 2000, DFAT provided additional information about the links between the loan and the bilateral relationship, which went some way towards addressing the Committee's concerns. Nevertheless, the Committee expressed the hope that, if any further loans were made under the Act, the NIS would include 'greater breadth and depth' of material on Australia's national interest.<sup>4</sup>

2.5 In relation to the issue of facilitating Parliamentary scrutiny of the loan process, the Committee was even more critical, expressing concerns about the time lapse between the execution of the loan on 21 June and the tabling of the NIS on 28 August 2000. There had been no contact with the Committee during that interval:

If Parliamentary scrutiny is to be effective, referral to the Committee should take place earlier in the process of executing a loan under the provisions of [the Act]. Referral of such a loan more than two months after it was executed is not a way of ensuring effective Parliamentary scrutiny. Such a process clearly concedes the principles of accountability and transparency, while equally obviously denying them in practice.<sup>5</sup>

2.6 Drawing a parallel with the operations of the Joint Standing Committee on Treaties, the JSCFADT concluded that it should be possible to arrive at a timetable that allows for consideration of loans under the Act before they are executed. Accordingly, the Committee recommended that the Act be further amended to ensure that Parliamentary scrutiny of loans proposed under its provisions occurs before such loans are executed.<sup>6</sup> Nevertheless, the Committee supported the execution of the first loan to PNG.

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3 JSCFADT, *op. cit.*, pp. 38-39.

4 *Ibid.*, p. 40.

5 *Ibid.*, p. 41.

6 *Ibid.*, pp. 41-42.

## The Second Loan

2.7 The purpose of a loan under the Act was outlined in the NIS dated 14 December 2000:

A transaction under [the Act] 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.<sup>7</sup>

2.8 The Committee notes with appreciation that Treasury maintained regular contact with the secretariat about the likely tabling date for the second NIS, well before tabling actually occurred.

## Update on the PNG Government's On-Going Reform Agenda

2.9 The Morauta government came into office in July 1999, with a platform of economic, political and institutional reform. The reform program, and the progress that had been made in areas such as budget stabilisation, development of guidelines for the Rural Development Program, improved transparency and accountability regimes and passage of key financial legislation, were discussed in detail in the Committee's previous report.<sup>8</sup>

## Political and Economic Developments

2.10 There have been a number of significant developments since the Committee's previous inquiry. As the High Commissioner for PNG stated in his submission, these have included the passage of the PNG Government's budget and political integrity legislation late last year. On the economic front, however, the High Commissioner acknowledged that the continued low level of commodity export prices (with the exception of oil) was a disappointing factor for the PNG Government, although this setback was expected to be temporary. The High Commissioner highlighted the substantial legislative program passed by the Parliament in the areas of governance, financial management, prudential regulation and the conduct of economic policy.<sup>9</sup>

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7 NIS, 14 December 2000, p. 1. (See also Treasury's evidence, Transcript, 9 March 2001, p. 9.

8 JSCFADT, op. cit., pp. 8-11 and 21.

9 HE Mr Renagi R Lohia CBE, Submission No. 1, pp. 2, 4.

- 2.11 On the economic front, Treasury confirmed that the PNG economy had not performed as strongly as had been anticipated earlier in 2000, with growth estimates declining from 4.7 per cent—at the time PNG's 2000 budget was passed—to 0.8 per cent in December 2000. The mining, agriculture and construction industries fell short of expectations in 2000, which constrained exports and weakened the exchange rate. Nevertheless, there have been substantial reductions in interest and inflation rates since the Morauta government came into office.<sup>10</sup>
- 2.12 In evidence, Treasury also informed the Committee that, excluding one-off structural costs and payments of arrears, the projected fiscal deficit outcome for 2001 is 1.3 per cent compared with 2.2 per cent in 1999 and an estimated 1.8 per cent for 2000. Treasury anticipates that, on the same basis, PNG's budget would be virtually in balance in 2001.<sup>11</sup>
- 2.13 Political reform remains an important but sensitive element of the PNG Government's reform program. Dr May and Professor Duncan from the Australian National University (ANU) suggested that several decades would probably elapse before the full effects of the political and economic reforms would be felt in PNG.<sup>12</sup>
- 2.14 Apart from the political integrity legislation and electoral reform, other recent reforms have included the Banking and Financial Institutions Amendment Act and the revised Central Bank Act designed to strengthen the supervision of banks and non-bank financial institutions.<sup>13</sup> DFAT informed the Committee of other important reforms such as draft legislation on electoral matters and the establishment of a Central Agencies Coordinating Committee (CACC) consisting of the heads of agencies such as Prime Minister's Department, the National Executive Council, Finance and Treasury. Australia has provided assistance to the Chief Secretary and the CACC to implement these reforms. With the assistance of the Asian Development Bank and funding support from Australia, an assessment of factors impeding effective delivery of health, education and agriculture services in four provinces was carried out in

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10 Treasury, Submission No. 2, pp. 3, 4.

11 Submission No. 2, p. 4. See also Dr Standish's evidence, Transcript, 9 March 2001, p. 17.

12 Transcript, 9 March 2001, pp. 24-25. The ANU panel comprised Dr Ron May, Dr Bill Standish, Professor Ron Duncan and Dr Theodore Levantis.

13 Treasury, Submission No. 2, p.4. The Organic Law on Political Parties and Candidates is popularly known as the Political Integrity Bill. See also ANU panel's evidence, Transcript, 9 March 2001, pp. 25, 26.

October 2000. A service improvement program has been developed and will be trialed in four provinces.<sup>14</sup>

## Relations with the World Bank and the IMF

- 2.15 Soon after the current inquiry commenced, the PNG Government decided not to renew the visa of the World Bank's resident coordinator in Port Moresby.<sup>15</sup> This action immediately caused speculation in Australia and elsewhere about the integrity of the structural adjustment program for PNG instituted by the IMF/World Bank, as well as Australia's involvement in the major PNG-Australia gas pipeline project for which Prime Minister Morauta had sought Australian financial assistance of up to A\$650 million.<sup>16</sup>
- 2.16 The rift with the World Bank, according to some analysts, had a number of negative consequences, some of which included:
- Re-focusing international attention on corruption and mismanagement in PNG;
  - Diminishing access in PNG to cheap credit, pushing down the value of the kina and possibly undermining business confidence;
  - Questioning in Australia and elsewhere of the ability of the Morauta government to implement its ambitious reform agenda.<sup>17</sup>
- 2.17 These perceptions were strongly rejected at the time by the PNG Government.<sup>18</sup> In evidence, the PNG High Commissioner re-affirmed the commitment of the PNG Government to implementation of its structural reform program in close consultation with the IMF and the World Bank. DFAT and Treasury also expressed confidence that the Bank's structural adjustment program remains on track, adding that PNG's record in repaying sovereign debt is very good.<sup>19</sup>

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14 DFAT, Submission No. 4, p. 4. Draft legislation to introduce a preferential voting system has been introduced in the Parliament, but would need substantial cross-party support to be passed into law.

15 *The Australian Financial Review*, 7 and 9 February 2001.

16 Reported in *The Australian Financial Review*, 7 and 9 February 2001, *The Canberra Times* and the AAP newswire on 11 and 12 February 2001 and *The Sydney Morning Herald*, 14 February 2001.

17 For example, reports in *The Australian Financial Review*, 9, 10 and 22 February 2001 and *The Sydney Morning Herald*, 14 February 2001.

18 Reported in *The Australian Financial Review* and the AAP newswire, 11 February 2001. Allegations of corruption re-surfaced in PNG's *Independent* newspaper on 22 February 2001 in relation to management of the Public Officers' Superannuation Fund.

19 PNG High Commissioner, Submission No. 1, p. 3; DFAT, Submission No. 4, p. 2 and Transcript, 9 March 2001, pp. 2-3; Treasury, Submission No. 2, p. 5 and Transcript, p.9.

- 2.18 A press release issued by the World Bank on 16 February corrected several 'misperceptions' that had arisen in reports of discussions between the PNG Government and the World Bank during that week. These included registration of deep concern about corruption as an issue in PNG and confirmation that there were a number of outstanding issues to be satisfactorily resolved before the next tranches of the adjustment loan could be disbursed. In evidence, the Australia-Papua New Guinea Business Council (APBC) highlighted the importance of PNG's meeting the IMF benchmarks. APBC also welcomed the focus being placed by the PNG Government on a partnership with the private sector to combat systemic corruption, citing Prime Minister Morauta's speech on 2 March 2001 to the PNG Institute of Directors.<sup>20</sup>
- 2.19 On 13 October 2000, the IMF's Executive Board concluded the first review under its 14-month (US\$115 million) Stand-By Arrangement with PNG. According to Treasury, the resulting report commented favourably on PNG's progress in implementing its macro-economic and structural reform agenda. The IMF's second review team visited Port Moresby in early November 2000 and the third review was conducted in February 2001. Treasury understands that the reports of the second and third reviews will be considered together by the IMF Board in April 2001, depending on the IMF's meeting schedules.<sup>21</sup>

## Development Cooperation

- 2.20 As DFAT explained, there is no direct relationship between the decision to grant loans to PNG and the delivery of Australia's A\$300 million Development Cooperation Program to PNG. However, the loans complement the financial and technical assistance that the Australian aid program is providing to PNG's structural reform agenda.<sup>22</sup>
- 2.21 Under the provisions of the Act, loans from Australia are advanced only in support of IMF programs of economic adjustment. Therefore, any withdrawal of support from the international financial institutions 'would affect the effectiveness of Australia's contribution through the aid program to structural reform efforts in PNG'.<sup>23</sup>

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20 Transcript, 9 March 2001, pp. 9, 12; AAP newswire, 1 March 2001 (story no. 0545).

21 Treasury, Submission No. 2, pp. 4, 5 and Transcript, 9 March 2001, p. 7.

22 DFAT, Submission No. 4, p. 5.

23 Ibid.

## Australia-PNG Ministerial Forum

- 2.22 On 27 February 2001, the 13<sup>th</sup> annual meeting between Australian and PNG ministers took place in Canberra. Major bilateral topics for discussion included the Morauta government's political and economic reform agenda, re-engagement with the World Bank and the IMF, restructuring of the PNGDF,<sup>24</sup> the PNG-Queensland pipeline project, developments in the Bougainville peace process, development cooperation, the environment, security cooperation and regional issues.
- 2.23 In Parliament on the day of the Forum, the Minister for Foreign Affairs welcomed the Morauta government's commitment to economic reform, its re-engagement with the IMF and the World Bank, reform of the PNGDF and the encouraging developments since the Kokopo Agreement (26 January 2001) in relation to Bougainville.<sup>25</sup>
- 2.24 In a Joint Statement issued after the Forum, the ministers noted the 'strong progress [PNG] has made in cementing the reform program begun by the Morauta government ... [and] the difficulties faced by the PNG Government in introducing and maintaining a broad program of economic, financial and political reform ...'.<sup>26</sup> Ministers welcomed the participation at the Forum of representatives from the respective business councils and business communities and their suggestions for improving two way trade and investment. The most recent trade statistics available to the Forum showed a balance of bilateral trade in PNG's favour with exports from PNG valued at \$1.4 billion while imports to PNG were valued at \$0.98 million in 2000.<sup>27</sup>
- 2.25 Leading from references at the public hearing to discussions at the Forum, the APBC witness indicated that, because the PNG Government had not provided adequately for an environment conducive to private sector development as well as participation by 'ordinary Papua New Guineans', there was still only limited interest from the Australian business community in new investment ventures.<sup>28</sup>

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24 Papua New Guinea Defence Force.

25 Hon Alexander Downer MP, House of Representatives, Hansard, 27 February 2001, p. 21229.

26 'Joint Statement, 13<sup>th</sup> Australia - Papua New Guinea Ministerial Forum', Canberra 27 February 2001. The full text of the Statement was attached to DFAT's Submission (No. 1).

27 Joint Statement, p. 2.

28 Transcript, 9 March 2001, p. 15.

## Continuing Concerns

- 2.26 Recent developments in several areas of concern, which Australia continues to monitor in the context of the bilateral relationship, are discussed in the following sections.

## Political and economic instability

### Political developments

- 2.27 In ministerial reshuffles since October 2000, 10 of the 27 ministers in the PNG Government have been removed for disloyalty or other alleged misconduct. The latest dismissal involved Sir Michael Somare, former Minister for Foreign Affairs and Bougainville Affairs, who was removed by the Prime Minister in December 2000. Sir Mekere Morauta managed to survive several challenges from within the Coalition ranks in the final weeks of the parliamentary sittings last year.
- 2.28 Parliament will not meet again until 23 July this year, ensuring that the Prime Minister can not be subjected to a vote of no-confidence before then. However, the PNG political scene is arguably more stable than it has been for a decade, although tensions continue to be evident within the coalition: the Peoples' Progress Party and the United Party were removed from the coalition, leaving the Government comprising the Peoples' Democratic Movement, John Pundari's Advance PNG Party and the Pangu Party led by Chris Haiveta. Somare, leader of the National Alliance Party, has announced his intention to contest the Prime Ministership in the June 2002 elections.<sup>29</sup>
- 2.29 DFAT and ANU witnesses agreed that adjournment of the PNG Parliament had ensured a valuable period of stability for the Morauta government and its reform program. Dr May and Dr Standish supported DFAT's assessment that the Morauta government represented the best opportunity for solving PNG's systemic problems, including corruption. In Dr May's view, this at least partly justified the level of on-going international and Australian support.<sup>30</sup>

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29 Sir Michael Somare's intentions were reported by *The Canberra Times*, 13 March 2001.

30 DFAT, Submission No. 4, p. 3. Transcript, 9 March 2001, p. 9 (DFAT) and pp. 17, 19, 24-25 (ANU panel).



## Economic developments

- 2.30 The NIS highlighted some of the significant indicators of economic instability inherited by the in-coming Morauta government: depleted foreign reserves, worsening macro-economic imbalances, collapse of the exchange rate, poor governance, strained relations with Australia and the international donor and investment community.<sup>31</sup> Although there are positive signs that considerable progress has since been made, the overall economic outlook is still regarded by many commentators as being subdued. Very mixed signals have arisen from continuation of a tight monetary policy (required by the IMF's Stand-By Arrangement), very low levels of bank lending to business, high interest rates and comparatively high inflation.<sup>32</sup>
- 2.31 The APBC's submission argued that PNG had yet to deliver all the necessary reforms required by the IMF/World Bank. Hence, in APBC's view, and that of several ANU witnesses, the NIS had been premature in claiming that investor confidence would be strengthened by Australia's financial assistance, ie until IMF structural adjustment benchmarks had been achieved.<sup>33</sup>

## The PNG to Queensland Gas Pipeline

- 2.32 Uncertainties and delays surrounding the gas pipeline project from PNG to Queensland surfaced again in January this year, with closures of the oil and gas production site for the PNG-Chevron project in the Southern Highlands as a result of disputes with traditional landowners. Issues of sovereign risk have still to be resolved, and press reports have suggested that the first gas deliveries may not be made until 2005.<sup>34</sup>
- 2.33 The APBC was reported in the press as suggesting that Australia should support the PNG Government, either directly by facilitating the financing of the project or indirectly through the Export Finance and Insurance Corporation and Invest Australia.<sup>35</sup> Treasury and DFAT informed the Committee that, although the pipeline project is not part of PNG's structural adjustment program, Australia recognises the importance of the project. Australia's view is that it should proceed on its commercial

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31 NIS, 14 December 2000, p. 1.

32 See, for example, *The Australian Financial Review*, 6 December 2000, pp. 8, 10 and 22 February 2001; AAP newswire, 27 December 2000; *The Sydney Morning Herald*, 9 January 2001, p. 10.

33 Submission No. 3, p. 3. Transcript, 9 March 2001, pp. 12, 14, 19.

34 See press reports in *The Australian*, *The Australian Financial Review* and *The Canberra Times*, 24 January 2001 and *The Courier Mail*, 26 January and 14 March 2001.

35 *The Australian Financial Review*, 9 March 2001.

merits, and Australian officials have discussed the financial arrangements extensively with PNG officials during the past six months. DFAT added that PNG's request for financial support was yet to be considered by the relevant Australian ministers.<sup>36</sup>

## Privatisation

- 2.34 Progress with privatisation of a number of PNG public entities such as Air Niugini, the PNG Banking Corporation and Telikom has generally been slow. Controlling interests in PostPNG, the Harbours Board and water assets are also scheduled to be sold. The PNG Government has been rightly concerned about the overall performance and heavy debt burdens of virtually every state-owned business, and hence the sale prospects of the more marginal performers.<sup>37</sup>
- 2.35 Treasury provided updated information in respect of the preparations for sale of the PNG Banking Corporation and Air Niugini. On 19 February, the PNG Government announced the regime of community service obligations that would apply to the banking sector after the forthcoming privatisation of the Corporation.
- 2.36 According to Treasury, recent progress has been rapid in the preparations for sale of Air Niugini, with up to 49 per cent of the equity to be sold in a partial trade sale which will mark the first privatisation of a significant government business enterprise 'after many years of failed attempts by many political leaders'. Treasury also pointed to significant progress in other components of the privatisation program.<sup>38</sup> According to the best information available to the APBC, 'due process' had been followed.<sup>39</sup>

## Bougainville peace process

- 2.37 Australia continues to monitor developments closely on the proposed autonomy referendum and other key issues, and to offer assistance in response to requests from the PNG Government. Following the important Kokopo Agreement of 26 January 2001, negotiations in Townsville during February brought together the largest number of PNG and Bougainville leaders ever assembled, including representatives of Francis Ona's rebel group. The main issues discussed were the disposal of weapons and the

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36 Treasury, Submission No. 2, p. 5 and DFAT, Transcript, 9 March 2001 p. 4.

37 Reported in *The Canberra Times*, 5 December 2000, p. 3. In evidence to the previous inquiry, Treasury highlighted the difficulties associated with such an ambitious program, given the history of attempted privatisation in PNG over the past ten years.

38 Submission No. 2, pp. 4, 5. See also APBC's evidence (Transcript, pp. 12, 13).

39 Transcript, 9 March 2001, p. 13.

form of autonomy to be developed for Bougainville under the referendum proposals.

- 2.38 At the conclusion of the discussions, there was no agreed settlement, although there were encouraging signs of progress between the parties on weapons containment and disposal. It was acknowledged, however, that there were still major hurdles to be overcome, particularly in relation to the terms of autonomy to be proposed for Bougainville.<sup>40</sup>
- 2.39 The Joint Statement issued by the Ministerial Forum noted that Australia's commitment of \$100 million in aid to Bougainville would be expended by mid 2002 and that Australia was prepared to consider further assistance through the aid program. Ministers also noted that the Peace Monitoring Group had been reduced in strength from 300 to 190, and acknowledged that reductions in the size of the Group would continue to occur.<sup>41</sup>
- 2.40 While acknowledging the progress made by the parties in peace negotiations and future arrangements for Bougainville, DFAT considered that any slowing of progress in the peace process would not impact directly on the success or otherwise of the PNG Government's reform program.<sup>42</sup>

## PNGDF and other issues

- 2.41 As mentioned in the Committee's previous report, the PNG and Australian governments have expressed concerns also about national stability in the face of secessionist movements and land ownership disputes emerging in the Southern and Central Highlands and elsewhere, border incursions by Operasi Papua Merdeka rebels into western PNG, police attacks on refugee care centres near the border with Irian Jaya, and other law and order and land tenure issues.<sup>43</sup>
- 2.42 In relation to reform of the PNGDF, the Committee noted that the recommendations of the Commonwealth Eminent Persons Group had been accepted by the PNG Government. Australia's continued support for

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40 Hon Alexander Downer MP, House of Representatives, Hansard, 27 February 2001, p 21229. See also the Joint Statement attached to Submission No. 4, from DFAT.

41 Joint Statement, 27 February 2001, pp. 3-4.

42 Transcript, 9 March 2001, p. 3.

43 *The Australian*, 9 March 2001; AAP newswire, 24-25 January, 8 February and 7 March 2001. For further details, see DFAT/AusAID's evidence, Submission No. 4, pp. 5-6 and Transcript, 9 March 2001, pp. 6-7, and evidence given by the ANU panel, pp. 17-18, 20-24.

restructuring the PNGDF was confirmed in February and March this year.<sup>44</sup>

- 2.43 However, on 14 March 2001, renegade PNGDF soldiers attacked the Murray Barracks armoury, looting 32 automatic weapons. This incident followed earlier riots, demonstrations and damage to military installations in Port Moresby and Wewak during February. On 17 March, Prime Minister Morauta announced that the proposed restructuring of the PNGDF had been cancelled, due to 'threats to the stability and future of the nation if the reform went ahead.' The Government's withdrawal from the recommendations of the leaked report of the Eminent Persons Group represents a serious setback, and signals a potentially very dangerous situation, after several years of simmering discontent within the PNGDF.<sup>45</sup>
- 2.44 In further developments at the time of writing, press reports suggested that the rebel soldiers, joined by others from Tarauma and Goldie River Barracks, had demanded the resignation of the Morauta government for being influenced too heavily by 'outside' organisations such as the World Bank. Other news reports indicated that the stolen weapons had not been returned, and there were unconfirmed rumours of an intended protest march on the Parliament.<sup>46</sup>

## Australia's National Interest

- 2.45 In explaining the reasons why a loan executed under the Act is in Australia's national interest, the NIS must have regard, in particular, to foreign policy, trade and economic interests. The Committee welcomes the additional material provided in the second NIS, which highlighted the following elements:
- historical, political, economic, strategic and social connections between the two countries;
  - the 'moral dimension' generated by PNG's status as one of Australia's few former colonial possessions;

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44 Joint Statement, 27 February 2001; press reports in *The Australian*, *The Australian Financial Review*, and *The [PNG]National*, 9 March 2001; Exhibit 1, Dr Bill Standish.

45 Reported in *The Australian* and *The Australian Financial Review*, 19 March 2001. See also evidence from Dr May, Transcript, 9 March 2001, pp. 25-26.

46 *The Australian*, *The Sydney Morning Herald*, *The Australian Financial Review*, 20 March 2001.

- the strong connection between Australia's trade and investment links with PNG and our own continuing economic performance;<sup>47</sup>
  - the reality that an increasingly self-sufficient PNG would make less demand on Australia's overseas aid budget; and
  - the positive response of the international community to the Morauta government's re-engagement with international financial institutions such as the IMF and the World Bank.<sup>48</sup>
- 2.46 In evidence to the first loans inquiry, DFAT argued there would have been grave consequences had the loan not been approved. PNG would have faced very real difficulties in promoting further its economic and fiscal reform programs, and in convincing the international financial community to continue to contribute to PNG's long term economic prosperity and growth.<sup>49</sup>
- 2.47 The Committee's previous report discussed the above issues in detail, and evidence at the public hearing for the second inquiry provided valuable additional information. For example, in its submission, the APBC expressed greater satisfaction with the second NIS than it did with the first, citing the inclusion of a number of very positive statements and a clearer explanation to the business community of the national interest in the context of Australia's relationship with PNG.<sup>50</sup>
- 2.48 In the Committee's view, the weight of evidence received in submissions and in subsequent evidence at the public hearing on 9 March 2001 consistently supported the execution of the loan as being in Australia's national interest.

## Nature and Terms of the Loan Agreement

- 2.49 As stated in the NIS, the key terms of the second loan are identical to those of the first loan executed in June last year—repayments are to commence 2¼ years from the dates of disbursement, with the repayment schedule spread equally over the ensuing 12 quarters. Interest is payable annually from the dates of disbursement. However, the NIS did not clearly explain

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47 As stated in the NIS, PNG is Australia's 11<sup>th</sup> largest investment destination and 18<sup>th</sup> largest trading partner. Total bilateral trade was valued at A\$2.1 billion in 1999.

48 As stated in the NIS, Japan and EU have resumed support, and PNG's economic readjustments have Australia's strong support.

49 DFAT, Submission, 6 October 2000 and Transcript, 12 September 2000, p. 19.

50 Submission No. 3, p. 2. See also DFAT's and Treasury's evidence, Transcript, 9 March 200.

how 'the terms of the loan more than cover the Commonwealth's cost of funds, thereby not imposing direct costs on the Australian taxpayer ... '. Similarly, the NIS states without further explanation that classification of the loan as an advance means that it 'will have no impact on the Commonwealth's fiscal and underlying cash balances, or net debt'.<sup>51</sup>

- 2.50 In a written submission, Treasury explained that the interest rate on the two loans to PNG was set at a margin above the cost at which the Commonwealth borrows, thereby providing a source of income for the Commonwealth. Treasury also explained the financial implications of granting the loans as advances.<sup>52</sup>
- 2.51 The current NIS highlighted the conditions necessary for granting Australian financial assistance under the Act, namely compliance with the conditions specified in section 8C:
- A formal request from the IMF;
  - Support from at least one other government or organisation;<sup>53</sup> and
  - Protection of the Commonwealth's interests in the event of suspension or premature termination of the IMF program.<sup>54</sup>
- 2.52 The Committee's previous report discussed in detail the key elements of the IMF program prescribed in the Stand-By Arrangement—fiscal restraint, continuation of tight monetary controls, and introduction of a number of structural reform initiatives. That report also discussed the major reforms supported by the World Bank's Structural Adjustment Loan—a focus on privatisation, service delivery in the health and education sectors, anti-corruption measures, reform of the finance and forestry sectors and the civil service, and other 'good governance' initiatives.<sup>55</sup>

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51 NIS, 14 December 2000, p. 4.

52 Treasury, Submission No. 2, p. 3.

53 The Japanese Bank for International Cooperation also provided a US\$50 million loan in support of the World Bank's structural adjustment program.

54 Default arrangements are set out in Clause 9.1(a) of the Loan Agreement. Other protection arrangements in the Loan Agreement include an indemnity clause, warranties and covenants provided by the PNG Government and the Bank of PNG.

55 JSCFADT, *op. cit.*, Chapter 3.

## Conclusions

- 2.53 The Committee considers that the second NIS is a much more informative document than the first one, both in terms of explaining Australia's national interest in the context of the bilateral relationship and the detail provided on the terms and conditions of the second loan to PNG. However, the Committee was disappointed with the Government's response to the report on the first loan to PNG.<sup>56</sup>
- 2.54 While noting the Committee's concerns about the timing of the tabling of the NIS and accepting the suggestions for improving the content of the NIS and liaison between Treasury and the Committee secretariat, the Government did not agree with the Committee's recommendation to amend the Act to enable the Committee to examine such loans before they are executed. At the public hearing, Treasury referred to its written submission that the introduction of a period of Parliamentary scrutiny of the NIS before a loan is executed 'could critically circumscribe Australia's capacity to contribute to financial rescue packages and could weaken the effectiveness of international support efforts for countries in crisis'.<sup>57</sup>
- 2.55 While acknowledging that prompt responses are essential in circumstances of acute regional difficulties such as the Asian financial crisis several years ago, the Committee remains of the view that a potentially small delay in the loan approval process in the case of PNG would not unduly impair Australia's ability to provide a timely response.
- 2.56 In expressing the above concerns, the Committee is nevertheless mindful of the importance of the bilateral relationship and the sensitivities involved in the dealings between Australia and PNG. Supporting a stable, prosperous and increasingly self-sufficient PNG is clearly in Australia's national interest.
- 2.57 The Committee welcomes the positive efforts that the PNG Government has made to re-establish relations with the IMF and the World Bank, and supports the second loan agreement.

## Future Loan Agreements

- 2.58 The Committee has again concluded that referral of the matter after the Loan Agreement has been entered into does not enable the Committee to

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56 The response was tabled in both Houses of the Parliament on 8 March 2001.

57 Submission No. 2, p. 2. See also Treasury's evidence, Transcript, 9 March 2001, p. 11.

undertake a meaningful examination of Australia's national interest and the terms of the loan. An 'after-the-event' review has limited value, and it is therefore necessary to make an opportunity for the Committee to provide more timely input to the loan consideration process.

- 2.59 The rationale for amendment to the Act in 1998 to include referral of the NIS to the Committee for inquiry and report (section 8F) is not particularly clear.<sup>58</sup> During the Second Reading debate on the amendments, the Deputy Leader of the Opposition did, however, make the following statement:

The particular national interest statement to be tabled in the parliament in this respect is also required by our amendments to be referred to the ... Joint Standing Committee on Foreign Affairs, Defence and Trade for inquiry and report. That is just a further means to ensure that there will be proper scrutiny and proper accountability but, hopefully, always delivered in a responsible way.<sup>59</sup>

- 2.60 When future loans under the Act are being considered, it is suggested that the relevant Commonwealth agencies provide a confidential briefing to the Committee, well before the NIS is finalised and the loan executed. This would enable early consideration by the Committee without jeopardising the timeliness of Australia's response to assist countries undertaking economic adjustment programs with the support of the IMF and the World Bank.

## Recommendation

- 2.61 The Committee again expresses its concerns about the timing of the (second) NIS and the impact this has had on its ability to examine the loan effectively. Accordingly the Committee re-affirms the recommendation made in its previous report, which called for further amendment of the *International Monetary Agreements Act 1947*, to ensure that Parliamentary scrutiny of proposed loans occurs before such loans are executed.

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58 In relation to the International Monetary Agreements Amendment Bill, the Committee's role was not delineated in either the Explanatory Memorandum tabled by the Treasurer nor in his Second Reading speech in the House on 12 March 1998.

59 Hon Gareth Evans MP, House of Representatives, Hansard, 26 March 1998, p. 1668.



## **Recommendation 1**

- 2.62 **That, should a further loan to Papua New Guinea be contemplated before the Act has been amended as proposed in the Committee's previous report, a confidential briefing be provided to the Committee on the draft NIS by the relevant Commonwealth agencies at the earliest opportunity. This should be arranged well before the National Interest Statement has been finalised and the loan executed.**
- 2.63 The short time-frame for the Committee's inquiry and report, which is inherent in the current legislation, has necessitated an abbreviated examination of the topic. The Committee therefore gratefully acknowledges the timely and valuable contributions made by all the organisations and individuals who provided input to the inquiry in the form of written submissions and/or evidence at the public hearing.

Senator Alan Ferguson  
Chairman

