

Fax sent bw : 61 2 62612248

6 March 2001

Mr Cliff Lawson
Secretary
Foreign Affairs Sub-Committee
Suite RI-120 *House of Representatives*
Parliament House
CANBERRA ACT 2600

Dear Mr. Lawson

Inquiry into the Second Australian Government Loan to Papua New Guinea

I attach a copy of the Department's response to the series of questions contained in your letter of 7 February 2001.

I apologise for the delay in providing this response and look forward to elaborating further at *the Committee's public hearing* on 9 March 2001.

Yours sincerely

John G W Oliver
Assistant Secretary
New Zealand and Papua New Guinea Branch

R 0 Casey Building, Barton ACF 0221 www.dfat.gov.au Telephone: 02-62612220

Inquiry into second Australian Government loan to PNG

Q.1 The conclusions and recommendations in the Committee's recent report (*Australian Government Loan to PNG, October 2000*)

We refer the Committee to the response that Treasury has provided to this question.

Q.2 A response to the Committee's criticism of the quality of the information provided in the NIS in relation to 'Australia's national interests.'

We sought to take on board the Committee's comments about the depth and breadth of the Department's contribution to the NIS, and consequently provided an expanded contribution to the NIS for the second loan.

Q.3 Comment on the political, economic and social circumstances in PNG, particularly where the situation may have changed since the loan matter was last considered (*September/October 2000*).

Since the Committee last considered this matter in September 2000, there have been a number of significant developments in PNG.

The Government survived a series of political challenges in parliament, secured the passage of the Organic Law on Political Parties and Candidates, adjourned parliament until July 2001 (thereby protecting itself from votes of no-confidence in the period January - July 2001) and secured itself in office until the next elections in 2002. This latter development was a significant factor contributing to the stability and continuity of government in Papua New Guinea. The PNG Government also added Defence Force reform to its already ambitious agenda. A report on PNGDF reform was prepared by a Commonwealth Eminent Persons Group (EPG) and presented to Prime Minister Morauta in December. The PNG Government is developing its response to that report.

Papua New Guinea has continued to make solid progress in its reform efforts. In recent weeks, however, differences have emerged between the government and the World Bank, leading to the dismissal of the World Bank representative in Port Moresby. These developments gave rise to perceptions in the international donor and business community that the outlook for reform was uncertain. The government has subsequently confirmed publicly that relations with the International Financial Institutions are sound. The Bank's structural adjustment program remains on track and an IMF mission is shortly to conclude a visit to PNG.

In the wider context, there was a most welcome breakthrough in the Bougainville peace process following the agreement on 26 January at Kokopo between the national government and the Bougainvillean parties on Bougainville's political future. This has been followed up by an intensification of settlement efforts to resolve the two main outstanding issues, weapons disposal and autonomy. At the request of the parties, talks were held in Townsville from 18-25 February to discuss weapons disposal.

Further talks on autonomy and weapons disposal are expected to take place over the next few weeks (see also question 9).

The Australian Government remains committed to support the PNG Government in the implementation of its reform program and will continue to provide financial and technical support. We believe that it is important for Papua New Guinea to maintain close and cooperative relations with the International Financial Institutions. The Government has welcomed, most recently at the Ministerial Forum on 27 February, PNG's assurance that it was fully committed to the reforms agreed with the IMF and the World Bank.

The Australian Government has welcomed the PNG Government's announced intention to substantially restructure the Defence Force. Developments in the Bougainville peace process, including the Townsville talks, are also very encouraging. Australia will continue to support efforts to resolve the Bougainville dispute through the aid program and the deployment of the Peace Monitoring Group. We will also continue to make a substantial contribution to the development of Bougainville.

In a somewhat different sense, there are other developments which may be gradually changing the social and political circumstances of PNG. These would include the continuing robustness of PNG's media, growing public interest in and debate about economic and political reform, better public understanding of the extent and need for reform action, especially against corruption and maladministration, and the need for law and order. Prime Minister Morauta is the champion of reform and his honest public statements that change will take time and be painful may be beginning to have an impact on public perceptions about reform. But these are difficult to quantify.

It is too early to tell what will be the impact of the reform process on the lives of ordinary people. It is to be hoped that reform will lay the foundation for economic recovery and a gradual improvement in the provision of basic services and standards of living. The passage of political and constitutional reform legislation, improvements in the structure and performance of state institutions, the public service, and the administration of justice, are all intended to bring about a gradual transformation of governance in PNG. The success of these reforms will do much to enhance the long-term development and prosperity of PNG.

It is therefore difficult to make any very hard and fast comments about political and social circumstances in PNG. For the man in the street, there has as yet been little by way of a reform dividend. It will take time for the benefits of the Government's reforms to flow down into improved social, political and economic outcomes for the majority of people.

Q.4 Outcomes from the annual Australia-PNG Ministerial Forum in Canberra (27 February 2001)

The annual Australia PNG Ministerial Forum was held on 26-27 February 2001. The Forum is an important opportunity to review developments in the bilateral relationship and to identify issues of importance that need to be addressed in the year ahead. This year, the key issues for consideration by Ministers included the PNG

Government's political and economic reform program, the Bougainville peace process, defence force reform, the PNG/Queensland gas pipeline, trade and investment, environment issues, immigration and bilateral security cooperation and regional issues (Irian Jaya, South Pacific).

A copy of the Joint Statement from the Ministerial Forum, which lists all major outcomes and points of discussion, is attached.

Q.5 Updated information on progress with, or setbacks to, the Morauta Government's reform program

(a) Key elements of the IMF economic reform program for PNG, including privatisation of public entities

The Treasury submission covers this matter in some detail.

(b) Reforms to the political process

Political reform remains an important but sensitive element in the Government's reform program. Perhaps the most significant development in recent months was the passage through parliament of the Organic Law on Political Parties and Candidates (popularly known as the Political Integrity Bill). Described by Prime Minister Morauta as "the most important event in PNG since Independence", the bill seeks to bring to an end the chronic instability that has plagued PNG since 1975 by strengthening the party system.

Other recent reforms include the development of a framework for management of rural development funds, and legislative reform, including the Central Bank Act (CBA) and the Banking and Financial Institutions Amendment Bill (BFIA). The CBA aims to strengthen the independence and accountability of the Central Bank and the BFIA to strengthen the supervision of banks and non-bank financial institutions.

Another important step in the reform process has been the establishment of a Central Agencies Coordinating Committee (CACC) consisting of the heads of central agencies (Prime Minister's and National Executive Council; Finance and Treasury; Attorney General's; Personnel Management and Planning and Monitoring). For the first time in many years, there is an active and, hopefully, an effective forum for the coordination of reform efforts and of government business more broadly. Australia has provided technical assistance to the Chief Secretary and CACC to implement these reforms.

The PNG Government's plans for institutional reform were further developed in the Medium Term Plan of Action for Public Sector Reform produced in August 2000. A Public Sector Reform Management Unit has been established to oversee the implementation of this plan. Functional and expenditure reviews of the following agencies are underway: Departments of Prime Minister's and National Executive Council; Defence; Foreign Affairs; Finance and Treasury; National Planning and Attorney General's. Others will follow. An assessment of issues impeding the effective delivery of health, education, and agriculture services in four provinces was also carried out in October 2000 with assistance from the Asian Development Bank and funding support from Australia. A Service Improvement Program has been prepared and will be trialled in four provinces.

Electoral reform - the PNG Government is also pressing ahead with efforts to change the voting system in PNG from first-past-the-post to a modified preferential system (a simplified preferential system operated reasonably successfully prior to Independence); the abolition of provincial seats in Parliament with open seats; and revisions to the Leadership Code, which would automatically disqualify any MP convicted of an indictable offence or declared insolvent. Draft legislation to introduce a preferential voting system has been introduced in Parliament but would need substantial cross-party support to be passed into law.

Review of provincial and local level government reforms - The Government has asked the Constitutional Development Commission to review PNG's system of provincial government and administration, with the objective of streamlining and reforming it. The review will be completed later this year.

(c) The Morauta Government's ongoing legislative program, and adjournment of Parliament until July 2001

Parliament was adjourned on 7 December 2000 until 23 July 2001. The Government's legislative program is therefore currently on hold. Some key reform bills, the 2001 Budget and the Political Integrity Bill were successfully put through Parliament prior to the adjournment.

Q.6 The relationship between Australia's aid program to PNG and the decision to grant the second loan

The decision to grant the second loan to PNG is not directly linked to the delivery of Australia's A\$300million Development Co-operation Program to PNG. However, along with the World Bank and the IMF loans, Australia's first loan of US\$80million and second loan of US\$30million complement the financial and technical assistance that the Australian aid program is providing to PNG's structural reform agenda.

Australia's loans are advanced only in support of IMF programs of economic adjustment. Because of the World Bank and the IMF's recent re- engagement with PNG, other bilateral loan assistance worth in excess of US\$60million has been provided. This may cease if the IFI's withdraw their support. Any withdrawal would affect the effectiveness of Australia's contribution through the aid program to structural reform efforts in PNG.

The focus of the aid program is on governance, education, health, infrastructure, renewable resources and assisting the peace process in Bougainville. The PNG-Australia Development Co-operation Treaty, which came into effect in July 2000, introduces performance benchmarks which will influence the level and allocation of funding of the development cooperation program.

Q.7 Law and order issues and their impact on PNG's internal stability

Crime and disorder has a significant impact on development and poverty reduction programs in PNG. It stifles economic activity, deters investment and undermines the ability of the private sector to generate broader growth and employment. It also impinges on the ability of women to access health and education services; the

incidence of violent crime on young women and girls in rural areas is a matter of particular concern. PNG continues to experience high levels of violence and crime in urban areas; inter-group fighting in the provinces, especially the Highlands, is common.

Law and order issues are sensitive and complex. The Government is well aware of the need to reduce the level of crime and violence in the community. However, rapid social, economic and political transformation will continue to generate tensions, divisions and dislocation. It will take time, patience, resources and determination on the part of government to bring about necessary change.

Australian Assistance

Australia has been supporting justice activities in PNG since 1988. It was one of five priority sectors targeted for assistance as the Australian aid program to PNG was progressively changed from budget support to program assistance. The recently concluded *Treaty on Development Cooperation* continues to accord high priority to the justice sector for Australian development assistance. Australian assistance to the law and justice sector amounts to about 10 per cent of the total aid program. The main focus of support has been the PNG Constabulary and the Correctional Services. More recently, other elements of the justice sector have been targeted for assistance including the Ombudsman Commission, Attorney General's Department, the courts administration, Office of the Legislative Counsel and the Legal Training Institute.

A review of Australian assistance to the sector was recently undertaken and a new strategy being formulated to guide future support. In line with the GoPNG Policy, the key objectives for Australian assistance are to:

- foster a sectoral approach to law and justice;
- encourage greater community participation;
- assist in the development of the preventative and restorative justice capacity;
- improve the efficiency and effectiveness of the deterrence system; and
- integrate intra-sectoral issues into AusAID's law and justice programs.

Q.8 Press reports that pressure is increasing on the Australian Government to respond to PNG's request for financial assistance with the Australia-PNG pipeline project

The question of PNG Government equity in the pipeline project is just one of a number of outstanding issues that need to be resolved before the project can proceed. Ministers are expected to consider the PNG Government's request shortly.

Q.9 Update on the situation on Bougainville (for example the agreed referendum and independence option, weapons disposal, Francis Ona) and the impact of secessionist developments elsewhere in PNG

On 26 January 2001 Bougainvillean and national government leaders reached agreement on a set of principles for the holding of a conditional referendum to decide Bougainville's future political status. The referendum would be held between 10-15 years, with the actual date to be agreed after consultations by the autonomous Bougainville government and the national government.

Subsequent to the agreement being signed, the National Executive Council endorsed the agreed principles on 1 February. In announcing the PNG's Government's support and acceptance of the agreed principles, Prime Minister Morauta reaffirmed the Government's position that there should be full implementation of weapons disposal prior to the elections for an autonomous Bougainville government. Negotiations on weapons disposal were held in Townsville during the period 18-25 February. The talks brought together the Bougainvillean leadership and armed factions and the national government. While there was no agreement on a weapons disposal program, the meeting was a significant achievement in itself and further talks on both weapons disposal and autonomy will be taking place over the coming weeks. In the past, the PNG Government has expressed concern that autonomy in Bougainville may encourage similar pressures from other provinces.

JOINT STATEMENT
13TH AUSTRALIA – PAPUA NEW GUINEA MINISTERIAL FORUM
CANBERRA
27 FEBRUARY 2001

The 13th Australia – Papua New Guinea Ministerial Forum was held in Parliament House, Canberra on 27th February 2001. The Hon Alexander Downer, Minister for Foreign Affairs chaired the meeting and led the Australian delegation which included Senator the Hon Robert Hill, Minister for Environment and Heritage, the Hon Peter Reith, Minister for Defence, The Hon Mark Vaile, Minister for Trade, the Hon Philip Ruddock, Minister for Immigration, Multicultural Affairs, Reconciliation and Aboriginal Affairs, Senator the Hon Nicholas Minchin, Minister for Industry, Science and Resources, Senator the Hon Chris Ellison, Minister for Justice and Customs, Senator the Hon Rod Kemp, Assistant Treasurer and Senator the Hon Kay Patterson, Parliamentary Secretary to the Minister for Foreign Affairs.

The Papua New Guinea delegation was led by the Hon Bart Philemon, Minister for Foreign Affairs and included the Hon Moi Avei, Minister for Planning and Implementation and Bougainville Affairs, the Hon Kilroy Genia, Minister for Defence, the Hon John Tekwie, Minister for Trade and Industry, the Hon Herowa Agiwa, Minister for Environment and Conservation, the Hon Puri Ruing, Minister for Justice, the Hon Jimson Sauk, Minister for Police, the Hon Alfred Pogo, Minister for Transport, the Hon Chris Haiveta, Minister for Petroleum and Energy and the Hon Sinai Brown, Vice Minister for Bougainville Affairs.

The two delegations acknowledged the importance both countries attached to the annual Ministerial meeting and the opportunity it presented to review developments in the bilateral relationship over the previous twelve months and to identify the new challenges on the agenda. Both delegations acknowledged the value of close Ministerial level consultation on these issues and the importance of building on the solid personal contact between Ministers and senior officials from both countries established over the years.

The two delegations reviewed the comprehensive range of issues which make up the bilateral relationship. Ministers acknowledged the strong progress Papua New Guinea has made in cementing the reform program begun by the Morauta government since coming to office in July 1999. Ministers acknowledged the difficulties faced by the PNG Government in introducing and maintaining a broad program of economic, financial and political reform but at the same time recognised that such a program was essential if Papua New Guinea were to correct the problems of the past and give Papua New Guinea the best opportunity to meet the challenges facing its people. Ministers commended the PNG Government on the progress made to date, especially the passage of legislation to promote stability and integrity in the country's political and parliamentary processes.

Australian Ministers confirmed that they stood ready to continue to support the PNG Government in the implementation of its reform program and would continue to provide financial and technical support to Papua New Guinea. Ministers noted the importance of Papua New Guinea maintaining the closest cooperative relationship with the International Financial institutions and, in this regard, noted the progress made recently in reconciling difficulties with World Bank officials. Ministers noted that Papua New Guinea had assured the international community that it remained committed to the reform program agreed to with the international financial institutions.

Ministers noted that the PNG Government's reform program had been extended to include the reform of the Papua New Guinea Defence Force. Ministers underlined the importance of this reform and welcomed the PNG Government's recent announcement of its intention to substantially restructure the Defence Force. Ministers noted that this was a priority task for Papua New Guinea and that close attention will be paid to this issue over the next few months leading to an early commencement of the restructuring exercise. The Australian Ministers reaffirmed the commitment of the Australian Government to PNGDF reform and restructuring.

Ministers noted that continuing Australian assistance under the Development Cooperation Treaty remained a vital part of the relationship. It greatly aided the development of Papua New Guinea and provided very valuable support to the PNG Government's own reform program. Ministers noted the improved performance of the development cooperation program with the successful introduction of the

Incentive Scheme. Ministers acknowledged the importance of Papua New Guinea's National Charter for Development.

Ministers acknowledged the high level of consultation and discussion between officials from both countries which has taken place over the last six months on the financial arrangements covering the PNG - Queensland Gas Pipeline. Ministers noted that these consultations were continuing. Ministers agreed that the gas pipeline was an important project which had the potential to provide considerable economic benefit to both countries. Ministers noted the role of Governments in facilitating the project and that the project should proceed on its commercial merits.

On the broader question of the trade and business relationship between the two countries, Ministers welcomed the participation of representatives from the respective business councils and business communities and the presentation of their joint report on the 2000 Business Action Plan and the 2001 Business Action Plan. Ministers welcomed the suggestions made by the Business Councils for improving two way trade and investment and asked that they continue to develop solutions to these important issues in consultation with officials from the two governments through the working group process. A report will be made to the next Forum on further ways to strengthen the trade and investment relationship between the two countries. Ministers noted that the most recent trade statistics showed a balance of trade in 2000 in PNG's favour with exports from PNG valued at \$1.4 billion while imports to PNG were valued at \$0.98 million.

On other key issues in the relationship, Ministers acknowledged the importance of the consultations undertaken during the visit in September 2000 by the Minister for the Environment and Heritage, Senator Hill, to strengthening bilateral cooperation on a number of important bilateral environmental issues.

Ministers noted that substantial progress had been made on the development of a program of cooperative activities which would support Papua New Guinea in conserving its significant biological diversity values and help it meet its international environment obligations. Australia has worked with Papua New Guinea to create conservation management tools. Progress on a range of other areas was also noted including reporting and monitoring systems for the Convention on International Trade in Endangered Species (CITES), turtle conservation, tree kangaroo conservation, and chemical management. Australia expressed its appreciation of Papua New Guinea's continued support of a South Pacific Whale Sanctuary proposal. A commitment was made to continue to build a cooperative and supportive relationship which could contribute to a sustainable management of Papua New Guinea's unique and biologically diverse environment.

Ministers also acknowledged valuable outcomes arising from the discussions between relevant PNG Government Ministers and Mr Ruddock, Minister for Immigration, Multicultural Affairs, Reconciliation and Aboriginal Affairs in October 2000. These consultations have strengthened cooperation aimed at preventing illegal third country nationals entering Australia. Both sides looked forward to the proposed visit by an Australian inter - agency delegation to Port Moresby in the near future to develop further bilateral cooperation in the area of border management. In this regard, Ministers also acknowledged the important work done in maintaining an effective program of security cooperation in the Torres Strait to prevent the illegal movement of people across the Strait. Ministers also acknowledged the important deliberations at the Torres Strait Joint Advisory Council Meeting in Cairns in January 2001 and the progress made there in resolving outstanding issues concerning the operation of the treaty and its impact on the daily life of the inhabitants of the Torres Strait. Ministers undertook to examine its recommendations.

Ministers acknowledged the **progress** that has occurred over the last twelve months, but particularly the last three months, towards reaching a settlement to the Bougainville dispute. Ministers agreed that the **Kokopo Agreement of 26 January 2001** in which the terms for a **referendum** on the future political status of Bougainville was agreed by the national government and the Bougainville leadership, was a major development in the peace process.

Ministers noted that important talks had taken place in **Townsville** on the issue of a weapons disposal plan and on the terms of autonomy for the province. Ministers acknowledged that the consultations in Townsville had helped to clarify the position of the parties on the question of a weapons disposal plan for the province and had seen some progress on this vital issue. Ministers noted that further

consultations on a comprehensive agreement will continue next week. Ministers encouraged the parties to find a solution to the weapons disposal issue.

Ministers noted that Australia remained prepared to assist in the resolution of the Bougainville dispute. Australia had provided the venue to the latest round of talks and was prepared to consider future options to help facilitate the resolution of the dispute. Ministers noted that Australia had made a significant contribution to bringing peace to Bougainville through its aid program and its contribution to the neutral regional Peace Monitoring Group. Ministers noted that the commitment of \$100 million in aid to Bougainville would be expended by mid 2002 and that Australia was prepared to consider further assistance to Bougainville through the aid program. Ministers noted that the Peace Monitoring Group was not a permanent presence on Bougainville and that it had been reduced in strength from 300 to 190. Ministers acknowledged that reductions in the size of the Peace Monitoring Group would continue to occur. Ministers welcomed Papua New Guinea's reaffirmation of its desire to achieve peace in Bougainville by peaceful means.

Ministers noted recent developments in the region, particularly developments in the South Pacific and in Indonesia.

The Forum accepted the invitation from Papua New Guinea to host the 14th Ministerial Forum in 2002 in Lae, Morobe Province.

Alexander Downer
Minister for Foreign Affairs

Bart Philemon
Minister for Foreign Affairs