



Group Corporate Affairs
Level 22, 100 Queen Street
Melbourne Vic 3000

Phone +61 3 9273 5035
Fax +61 3 9273 5300
www.anz.com

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The Secretary
Senate Foreign Affairs, Defence and Trade Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

The Secretary,

Re: Inquiry into the main economic and security challenges facing Papua New Guinea and the Island States of the Southwest Pacific

Australia and New Zealand Banking Group Ltd (ANZ) welcomes the opportunity to provide a submission to the Committee on its inquiry into the main economic and security challenges facing Papua New Guinea and the Island States of the Southwest Pacific. The principal focus of this submission is PNG, however a number of our comments pertaining to PNG also have relevance to a number of Island States in which we operate.

This submission draws on ANZ's experience in PNG (and the Pacific region more broadly) and outlines our assessment of the main barriers to the country's economic development. PNG's ability to address these barriers will depend on continued economic growth, sound economic management and the Government's capacity and willingness to implement policies to overcome structural and institutional weaknesses. In particular, the PNG Government must develop short-to-medium term policy responses to law and order, basic healthcare and education, economic stability and growth (including infrastructure development), and environmental planning and management issues to ensure the country moves to a sustainable, higher growth path.

ANZ is strongly supportive of Australian Government efforts to deliver effective, targeted development assistance to address the economic and development challenges facing PNG and other Pacific Island states. The Australian Government's Partnership for Development with the Government of PNG identifies many of the issues ANZ believes must be addressed in order for PNG to move a higher growth path. Within the context of this inquiry, ANZ believes the following should be the focus in developing and/or refining programs to deliver practical and concrete assistance to meet some of the challenges faced by PNG:

- o Continue to deliver capacity building programs to help PNG build an effective, transparent bureaucracy and to address institutional weaknesses;

- Improve internal security, including through strengthening law and order and accountability institutions such as the Office of the Ombudsman; and
- Strengthen public administration to improve service delivery (including in education and health services).

ANZ in the Pacific

ANZ has been operating in the Pacific for over 150 years, employs over 2000 staff and is the largest bank in the region, operating full service retail and commercial banking in 11 Pacific countries: PNG, Fiji, Solomon Islands, American Samoa, Samoa, Cook Islands, Tonga, Vanuatu, Kiribati, Timor Leste and Guam and a representative office in New Caledonia. Of these, PNG is our biggest market.

We are committed to expanding our operations in the region. For example, in June 2007, we finalised an agreement to acquire the Citizens Security Bank (CSB), in Guam. In the same year, we opened two branches in PNG, seven branches in Solomon Islands and a new branch in Aitutaki (Cook Islands).

ANZ has a commitment to financial literacy and inclusion and runs a program called 'Banking the un-banked' in the region. 'Banking the un-banked' delivers basic, affordable and reliable banking services to remote and disadvantaged communities in the region, in partnership with the United Nations Development Program (UNDP), to provide financial literacy education. Since launching the program in October 2004, 75,000 previously unbanked rural people have opened savings accounts in a number of Pacific countries (including Fiji, Samoa, Tonga, American Samoa, Vanuatu, Solomon Islands). We have plans to offer savings accounts in PNG and Timor Leste as well.

ANZ has developed two products specifically for this program:

1. A savings account which is operated with a passbook and earns interest on every dollar
2. An everyday account which is suitable for salary earners, micro-business owners and those who want to make regular deposits and withdrawals; it has a small monthly fee and is operated with a passbook, although a debit card can be connected to the account.

In addition to 'Banking the un-banked', ANZ also offers micro-loans to regular savers. A micro-loan of \$100 can start a small business which in turn can lead to increased income and better living conditions. ANZ's rural banking customers in a number of countries in the Pacific are now graduating from saving to obtaining micro-loans to regular small business loans. Micro-loans have been used to fund small projects such as new roofs and solar power installations as well as school fees, boats and better living conditions generally.

ANZ is also partnering with the World Bank to bring environmentally sustainable energy to villages and businesses in Pacific Island countries. As part of the program, ANZ will distribute \$9.5 million of World Bank funding over the next five years to help local financial institutions provide affordable loans to rural communities for the purchase of renewable energy such as solar energy, hydro energy and biofuels (coconut oils). We will also participate in the program as a lender.

ANZ aims to play a leading role in assisting the development of governance standards and regulations in the Pacific states in which we operate. For example, we are undertaking an initiative to identify and understand all regulatory obligations impacting our operations in the region in collaboration with local regulators and are involved in business and government working groups to strengthen these standards. Through our work to enhance governance standards and risk management in our Pacific operations, ANZ has been recognised by local regulators for improving standards of governance within the region more broadly.

Political stability and good governance

While PNG's short-term economic outlook is relatively positive, current levels of growth are insufficient to reduce poverty and improve the quality of life for the majority of the population. The rural sector still provides about 40 per cent of GDP compared with about 25 per cent for all the resources sector combined, and is a much greater source of employment. The development of the rural sector will remain a priority for the Government but there are multiple complex challenges that need to be addressed in order to drive growth in other sectors of the economy (see discussion below).

In recent years, the PNG Government has done a sound job in establishing macroeconomic stability, and for the first time since independence the economy is experiencing its fifth consecutive year of positive growth. The turnaround in macroeconomic performance over the past few years is noteworthy with a number of key factors having brought it about, including the implementation of prudent fiscal policy through an explicit deficit and public sector debt reduction program, reforms to strengthen the independence and regulatory authority of the central bank and strong external demand for commodities.

PNG's economic growth has also coincided with a period of relative political stability that is unprecedented in PNG's history since independence. The Government under Sir Michael Somare (first elected in 2002) was the first to complete its term in office without suffering a vote of no-confidence. Work within that Government on improving PNG's economic policy framework and related governance structures have helped improve the country's economic fortunes. As the economy has grown and the benefits of fiscal discipline have become increasingly better understood, there has been a growing consensus politically about the need to consolidate and expand these reforms. Notwithstanding, investment and development continue to be constrained by the country's quality of governance, particularly poor standards of public services, serious law and order

problems and other institutional weaknesses, including weak compliance and implementation of legislative frameworks.

The political transition to a new government through the 2007 general election was a milestone. The success of the elections, combined with continued macroeconomic stability and falling debt levels, has prompted S&P to raise PNG's creditworthiness. Based on current data, PNG's creditworthiness continues to build and is on track to attain a "BB" credit rating within the next year or two. Ratings upgrades of this nature are important as they lower the risk premium associated with offshore funding of investments in PNG, as well as associated insurance costs, and influence the flow of investment and private sector activity in the country.

Looking ahead, PNG's economic development will depend on its ability to restore fiscal discipline, a process that will take many years and sustained political commitment. In terms of public finance management, there is now greater transparency and consultation with the private sector and the wider population around the preparation of the budget. Notwithstanding, more work is needed to ensure greater headway is made to improve public sector governance, particularly in the areas of compliance and implementation of legislation. In this context, continued Australian Government assistance will be crucial in helping PNG to build an effective, transparent bureaucracy and to assist it to address institutional weaknesses impacting economic development and other necessary reforms across government.

It is worth noting that PNG's Office of the Ombudsman has been able to maintain a degree of independence and has done a relatively good job as the public's watchdog on the conduct of political leaders. The Ombudsman also plays an important role in policing PNG's Leadership code and its role should be strengthened to allow it to assume a more prominent role in driving transparency and accountability across government. Ongoing Australian Government assistance to strengthen PNG's law and order and accountability institutions will be important in helping to break serious bureaucratic bottlenecks and to tackling endemic corruption.

Key challenges to PNG's economic development

The following discussion outlines our assessment of the main barriers to PNG's economic development. The country's ability to address these barriers will rely upon continued economic growth, sound economic management and the Government's capacity and preparedness to implement policies to overcome structural and institutional weaknesses. In particular, the Government must develop short-to-medium term policy responses to law and order, basic healthcare and education, economic stability and growth (including infrastructure development), and environmental planning and management issues to ensure the country moves to a sustainable, higher growth path.

As already noted, PNG has made good progress in the development of its financial sector, including through a series of reforms that have strengthened the independence and regulatory authority of the central

bank. While these reforms have helped establish a prudentially sound banking sector and put in place some of the pre-conditions for economic growth, an expansion of retail banking services to areas of the country not covered by commercial banks will be integral to encouraging broad-based economic growth. However, from ANZ's perspective, retail banking operations are not generally inhibited by PNG's financial sector policies or regulations but principally by considerations such as law and order, infrastructure constraints and access to reliable utilities and skilled staff.

Law and order in PNG presents one of the most significant barriers for the country's economic and social development. PNG suffers from a level of lawlessness that is disproportionate to its population and economic size. PNG's law and order problems impact significantly on quality of life of its citizens and seriously restrict investment and private sector development. While job creation is crucial in reducing rates of crime, more effective law enforcement measures must also be implemented. The PNG Government's recent decision to boost funding for the police force by PGK3 million is a welcome development and one which requires an ongoing commitment over the short-to-medium term. ANZ closely monitors law and order developments to ensure the safety of our staff and operations and our geographic footprint in the country is guided in large part by security considerations. For example, our ability to roll out our 'Banking the un-banked' program in regional areas is constrained by law and order considerations.

Aside from security considerations, ANZ's operations in PNG are confined to those areas of the country where we have access to infrastructure and utilities able to reliably support our operations. Infrastructure development and maintenance represents an ongoing barrier to PNG's economic growth and one which requires a comprehensive policy response. Addressing some of PNG's infrastructure constraints, including poor road and telecommunication networks, would help connect rural areas with commercial hubs, enable farmers to get their produce to market, improve access to services (including banking services) and information and reduce the cost of doing business in PNG more broadly.

Critical utilities for economic growth, including potable water, electricity and telecommunications, are not widely available in PNG, especially in rural areas. These services have suffered from a lack of capital investment and poor maintenance and performance. The difficulties in managing the country's utilities highlight the need for the Government to consider allowing greater involvement of the private sector in the ownership and operation of PNG's utility providers to improve the delivery of essential services across the country. PNG's current strong levels of economic growth provide an opportunity to adopt some of the structural reforms needed to open state-controlled sectors to competition and to boost investment in the country's infrastructure. However, any move down this path would have to be accompanied by the implementation of a transparent and effective regulatory framework to provide certainty around any private sector investment. The implementation of any reform of the country's state-controlled sectors would require significant assistance and is an area in which the Australian Government might

provide appropriate technical support and expertise, possibly in conjunction with the private sector.

Effective delivery of public services is critical to the welfare of citizens and without it PNG is likely to confront increasing difficulty in ensuring stability and cohesion. With almost 85 per cent of the population living in rural areas, serious law and order problems and HIV/AIDS now an epidemic, the country's poor government services must improve. PNG (as with other countries in the region) has been poor at simple service delivery, however the country's positive economic performance in recent years presents an opportunity for the Government to improve the delivery of key services, particularly the development of policy responses for the provision of accessible, basic education and healthcare services - both fundamental in building human capital and boosting workforce productivity, encouraging entrepreneurial drive and delivering economic growth.

Australia already commits significant resources to working with PNG institutions to strengthen public administration to improve service delivery (including in education and health services), however consideration could be given to enhancing opportunities for short-term training opportunities in Australia for key personnel involved in the delivery of PNG's public services, including senior public servants, teachers and nurses. Consideration could also be given to developing programs to deepen financial literacy levels in PNG and the Pacific region more broadly to improve social welfare outcomes. As outlined above, ANZ is already working to improve financial literacy in the region and is working with governments and NGOs to deliver these programs. Developing infrastructure in Pacific economies so communities have access to a range of financial products and services is important to the communities in which they are offered as well as the economy more broadly. However, efforts in this area will have a better chance of succeeding if individuals and communities are provided with the financial education needed to understand both the benefits and downsides of easier access to financial services. As noted above, ANZ has considerable expertise in the delivery of financial literacy programs and this represents one area in which it could work with the Australian Government to deliver improved social and economic outcomes in the Pacific.

In terms of health services, Australian Government efforts to support PNG's response to HIV/AIDS will be crucial. The human, social and economic impacts of HIV/AIDS pose a critical challenge and is one for which PNG requires significant external assistance to effectively manage. The Australian Government's focus on enhancing preventative efforts will be critical in helping to reduce the spread of the epidemic and to build the capacity in PNG Government agencies to effectively implement effective responses within the PNG setting.

Given the importance of PNG's forestry, fishing, agriculture, mining and petroleum sectors to the economy, assisting PNG to build its capacity to effectively and transparently manage these sectors will be critical to ensuring long-term commercially and environmentally viable industries. However, as noted in the Asian Development Bank's March 2006 report into Governance in PNG, in many resource-rich and capacity-poor

economies, policy and institutional weaknesses have facilitated 'rent-seeking' behavior by public officials. In this regard, critical areas of concern continue to include budget management, forestry, fisheries and public procurement. While many of PNG's legal, structural and policy frameworks to prevent and address corruption are adequate, weaknesses lie in implementation, including lack of political will and limited capacity (financial and human) to fight corruption. Further assisting PNG to implement effective, broad-based reforms and improve the management of these resources will contribute significantly to reduced levels of corruption and tolerance for it. Australian expertise in resource management would also be invaluable in assisting PNG (and other resource rich Pacific island states) move to more sustainable, transparent resource management practices.

Over the medium-to-long term, promoting the domestic private sector and attracting foreign investment will be crucial in generating broad-based economic expansion in PNG and in generating employment opportunities and income. However, placing greater emphasis on private sector development will require further improvements in the business environment, including through the development of a sound regulatory framework, significantly improved corporate governance and transparency. The improved protection of property rights, particularly in relation to land is also needed to boost private sector investment.

With agriculture representing a large part the economy and employing such a large proportion of the population, land tenure remains a major issue. Without the ability to buy and sell land and establish legal title, there is little incentive to invest in long-term agricultural projects to drive productivity in the sector. It also delays infrastructure projects and makes financing decisions regarding these projects difficult. The absence of formal land titling also presents problems in the provision of finance for small business development.

While land ownership issues are complex, involving customary, local jurisdictional and community issues, progress needs to be made to reform property rights if the general level of prosperity in PNG is to improve. The mining industry has demonstrated that sensitive land ownership issues can be managed and the sector's approach for handling these issues could potentially be replicated across other parts of the economy. Australia could consider providing assistance to help PNG (and other Pacific Island states) develop arbitration and mediation procedures for land disputes which would make the administration of land law more efficient.

Further Australian Government assistance

Maintaining good bilateral relations is the basis of Australia's influence in the region. Australia has a strong interest in the Pacific's development and stability and the Port Moresby Declaration earlier this year is a clear demonstration of Australia's commitment to the region. ANZ strongly supports the Government's Pacific Partnerships for Development – a key component of the Declaration – which is designed to assist Pacific countries to strengthen their economic performance and governance

frameworks; encourage private sector development; achieve universal basic education; deliver better access to basic health services; and enhance governance structures more broadly. The underlying principles of mutual respect and responsibility will be important in driving leadership of development policy and in encouraging more effective and efficient use of development assistance. The appointment of a Parliamentary Secretary for Pacific Island Affairs is another positive development - one which serves to reinforce the importance Australia attaches to the region – and one which ANZ strongly supports.

More broadly, ANZ is of the view that Australian Government assistance to help PNG (and other Pacific island nations) become more integrated regionally, including through closer cooperation on trade, would greatly assist stable and long-term economic growth both in PNG and the region. The Australian Government's plan to take forward negotiations for a regional Free Trade Agreement, building on the Pacific Island Countries' Trade Agreement, and the Pacific Agreement on Closer Economic Relations, is a positive development and one which ANZ would strongly support. A regional FTA could also promote greater people-to-people links and improve opportunities for employment across the region, including for Pacific island citizens in Australia. The Government's Seasonal Worker Pilot Scheme is a positive first step in providing Pacific Islanders with access to Australia's labour market. The Government's intention to work with Pacific countries on bilateral packages to build national capacities to trade is also a positive development and one which will lead to increased trade flows among Pacific states and deliver stable, long-term economic growth in the region.

The Australian Government could also seek to make greater use of 'soft power' for engaging with the region, including through drawing upon the strong civil society networks that exist between Australia and countries in the region. The promotion of people-to-people and cultural links between Australian and the Pacific would deliver a wide range of positive outcomes, including greater awareness of Australia in the Pacific and vice-versa.

Conclusion

PNG continues to face significant political, social and economic challenges. Sustained economic growth is vital to reduce poverty and improve the quality of life for the majority of PNG's citizens.

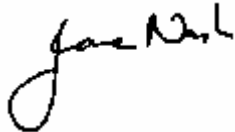
PNG's recent period of political stability has had a significant, positive impact on the economic fortunes of the country. As the benefits of fiscal discipline are becoming clearer to the wider population, there also appears to be greater consensus forming around the need for the Government to maintain this discipline.

Encouraging private sector activity and attracting foreign investment will be crucial in generating broad-based economic growth in PNG. Creating a commercial environment with a transparent regulatory framework, reduced levels of crime, and improved corporate governance and transparency would go some way toward facilitating private sector growth.

This, combined with serious efforts to assist PNG to integrate more closely with the region (possibly through a regional FTA), would go a significant way to helping PNG move to a higher growth path.

ANZ would welcome the opportunity to meet with the committee to discuss this submission in more detail and can be contacted on 03 9273 6323 or jane.nash@anz.com.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jane Nash', written in a cursive style.

Jane Nash
Head of Government and Regulatory Affairs