



Australian Government

National Interest Statement:

Loan Agreement between the Commonwealth of Australia
and the Independent State of Papua New Guinea

DECEMBER 2020

NATIONAL INTEREST STATEMENT

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Summary

This National Interest Statement (Statement) relates to the loan agreement between Australia and the Independent State of Papua New Guinea (PNG) for \$140 million plus approximately US\$305.29 million. This Statement is being tabled pursuant to the requirements of sections 8D-8E of the *International Monetary Agreements Act 1947* (IMA Act).

On 22 November 2020, Australia entered into a loan agreement with PNG to provide budget support to PNG and to support its reform actions under the International Monetary Fund (IMF) Staff-Monitored Program (SMP). This loan will also reinforce the already strong ties and special relationship that Australia has had with PNG over many years.

The Australian Government is providing the loan in response to a request from the PNG Prime Minister, Mr James Marape, in February 2020. The request was made to help address the deteriorating fiscal position that PNG has been facing in recent years and to support PNG's continued economic reform agenda. Since then COVID-19 has further exacerbated PNG's financial position. The Supplementary Budget, released in November 2020, estimated a 20.8 per cent decline in total government revenue for 2020 compared to the revenue estimate released in to 2019.

The loan amount comprises a \$140 million loan and a refinancing of a US\$300 million loan that PNG already had with Export Finance Australia (EFA), the Australian Government's export credit agency, which PNG entered into in November 2019. In effect, this loan agreement provides PNG with \$140 million in new funding and replaces the debt PNG has with EFA with a debt to the Australian Government.

Legislative requirements

The IMA Act (section 8C(1)) provides that Australia may enter into an agreement for a loan to another country where the loan provides financial assistance in support of an IMF program to another country and if the Treasurer is satisfied that at least one other government or organisation has, or will be, providing similar assistance.

PNG is currently undertaking an IMF program through its participation in an IMF SMP. On 7 September 2019, PNG wrote to the IMF requesting an IMF supported program. On 20 February 2020, the IMF approved an 18-month SMP that continues until mid-2021. The SMP provides PNG with an opportunity to establish a track record of implementing reforms, and can also provide a basis for a future IMF financially-supported program. PNG's reforms include fiscal consolidation, expansion of revenues, containing operating expenditure and reform of State-Owned Enterprises. The reforms being undertaken by PNG are being supported with IMF technical advice in addition to financial support and technical assistance from the Australian Government.

In addition to the support that PNG is getting through the IMF SMP, the New Zealand Government has committed to provide financial support to PNG's reform agenda. New Zealand continues to explore options for providing grant funding to PNG's Treasury. PNG has expressed a strong interest in working with partners such as Australia, the Asian Development Bank (ADB) and the IMF in accessing credit, and is pursuing discussions with the ADB and other trusted partners to help meet its financing needs.

This Statement is tabled pursuant to the requirements of sections 8D-8E of the IMA Act. The IMA Act requires the Treasurer to table a Statement as soon as practicable after entering into such an agreement. The Statement should include a description, in as much detail as practicable, of the nature and terms of the agreement; and the reasons why the agreement is in Australia's national interest, having regard, in particular, to foreign policy, trade and economic interests.

National Interest Assessment

This loan will provide PNG with financial relief and provide it space to undertake needed economic reforms. Australia has a unique history and relationship with PNG that has existed since PNG's independence in 1975. PNG is Australia's closest neighbour, with just four kilometres separating the two countries at their nearest point. As PNG's closest partner in trade and investment, development assistance support and defence, it is in Australia's interests to have an economically stable partner with sustainable fiscal management.

Without this, there is a risk that Australia would be adversely affected by potential problems arising in PNG, including from issues related to public health, trans-national crime, and social unrest. An economically successful PNG would also be beneficial for regional stability in the Pacific, and would create opportunities and reduce risks for Australian businesses and investments in PNG.

Government relations between the two countries are underpinned by the Comprehensive Strategic and Economic Partnership of 2020 and the Joint Declaration for a New Papua New Guinea-Australia Partnership, which is built on the Joint Declaration of Principles of 1987 (revised in 1992). The development assistance cooperation program is underpinned by the Treaty on Development Cooperation (1999) and the PNG-Australia Partnership for Development (2008). Australian and PNG leaders and ministers are in close and regular contact, including through an Annual Leaders' Dialogue and Ministerial Forum.

Australia is PNG's largest trading and commercial partner, with bilateral trade worth \$7.5 billion in 2018-19. Major Australian exports to PNG are crude petroleum, meat, civil engineering equipment and parts, specialised machinery and parts and wheat. Major imports to Australia from PNG are gold, crude petroleum, silver and platinum.

Australian investment in PNG was worth \$17 billion in 2018. The resource sector has traditionally been a focus of this investment, particularly gold, mining and oil, and liquified natural gas. Australian investment has also been directed towards light manufacturing, infrastructure and service delivery. Over 4,000 Australian companies do business with PNG.

However, PNG faces a number of challenges to its future prosperity including under-funded law and order agencies, capacity constraints in the public service, lack of infrastructure, high poverty, income inequality, and a rapidly growing population. PNG also remains vulnerable to climate change and natural disasters, including earthquakes, volcanoes, landslides and tsunamis. Australia is a strong supporter of PNG – Australia is PNG's largest development assistance partner and PNG is also Australia's biggest development assistance recipient. Australia will provide an estimated \$491.1 million in aid to PNG in 2020-21. The development challenges facing PNG are being exacerbated by COVID-19.

Nature and terms of the Loan Agreement

On 22 November 2020, Australia and PNG entered into a 15-year loan. The loan is being provided in response to a request from the PNG Prime Minister, Mr James Marape.

The total loan comprises a \$140 million Australian dollar loan and a refinancing of a US\$300 million loan that PNG already had with EFA. The US\$300 million loan also had associated deferred interest repayments of US\$5.29 million. The deferred interest payments were the result of PNG accepting EFA's offer of a temporary suspension of loan repayments. This offer followed Australia's participation in the G20 decision that its members suspend the repayment of loan principal and interest from 1 May 2020 for members' loans to developing countries.

The \$140 million component of the loan has been drawn down by PNG. The US\$300 million plus approximately US\$5.29 million deferred interest component of the loan has been paid directly by the Australian Government to EFA to extinguish PNG's loan with EFA.

The base interest rate of the loan is set at the 10-year Australian Government bond rate as at the date before PNG's drawdown of the loan, which was 0.89 per cent. This rate, along with the rates of other Australian Government Securities (AGS), is published on the Reserve Bank of Australia website. An additional 0.5 per cent margin is added to the base interest rate to cover administrative costs associated with the loan. Repayments of the loan principal and interest are six monthly. The loan is designed to ensure that it can be provided to PNG at no cost to Australian taxpayers.

The 10-year Australian Government bond rate is a globally relevant benchmark indicator that the Australian Office of Financial Management uses to monitor the cost of the Government's debt portfolio. It also represents a highly liquid part of the AGS yield curve. It is a simple and transparent option for approximating Australia's cost of borrowing, and avoids the administrative burden of periodically resetting the interest rate as would be the case for a variable rate.

Australia has an option to review the loan's interest rate 10 years after drawdown, at which time the rate can be amended if it no longer aligns with the Australian Government's cost of borrowing.