



Australian Government

National Interest Statement:

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

February 2022

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 A\$650 million. This Statement is being tabled pursuant to the requirements of sections 8D-8E of the *International Monetary Agreements Act 1947* (IMA Act).

This loan is provided in response to a request from the PNG Prime Minister, Mr James Marape, by letter on 20 September 2021. In his letter, PM Marape thanked Australia for support during the COVID outbreak and noted that further support is crucial to enable the PNG Government to meet required expenditures in their 2021 Budget including on the health and economic response to the pandemic.

Australia's positive response to the PNG request is based on the importance the Government attaches to the bilateral relationship with PNG. As the 2017 Foreign Policy White Paper noted, PNG's "security and stability is a fundamental Australian strategic interest". The loan builds on the previous budget support loan Australia provided in 2020. This loan represents Australia's continued support to our close neighbour under the Comprehensive Strategic and Economic Partnership Australia has with PNG.

On 10 December 2021, Australia entered into a loan agreement with PNG to provide support to PNG to meet its 2021 budget financing shortfall, help it respond to the ongoing economic impact of the COVID-19 pandemic, and continue progress on economic reforms under the second International Monetary Fund (IMF) Staff-Monitored Program (SMP).

PNG has experienced significant economic challenges which has led to an increased financing need in their 2021 budget. PNG's 2021 MYEFO reported a significant reduction in real GDP growth, caused by ongoing impacts from COVID-19 and disruption to economic activity, particularly in the resources sector. The damage to PNG's economy has also impaired the country's fiscal position with its MYEFO reporting a 2021 deficit of US\$1.87 billion (A\$2.6 billion) or 7.2 per cent of GDP.

The loan is provided at the Australian Government's cost of borrowing plus a fee and involves no cost to the Australian taxpayer.

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 IMFSMP. Following a request from PNG for an IMF supported program, on 21 December 2021 the IMF approved a 6-month SMP that continues until mid-2022. The SMP provides PNG with an opportunity to continue establishing a track record of implementing reforms, providing the 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.

In addition to the technical support PNG is getting through the IMF SMP, the New Zealand Government has committed to provide financial support which supports PNG's economic resilience and aligns with PNG's reform agenda (including the IMF SMP). New Zealand will provide grant funding of USD3 million to PNG's Treasury.

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

Australia and PNG are sovereign partners who share unique and enduring connections that span decades, and our special relationship is underpinned by a shared history, geographic proximity, common interests and cooperation across all spheres. As the 2017 Foreign Policy White Paper states, PNG's "security and stability is a fundamental Australian strategic interest". It is in Australia's interests to have an economically stable partner with sustainable fiscal management. Assisting PNG to recover from the impacts of the COVID-19 pandemic and working with them to continue to build long term fiscal security helps generate regional stability. These considerations are core to Australia's decision to approve the loan.

The loan will make a significant contribution towards PNG's financing gap in 2021. It will also provide PNG with the ability to continue its economic reform agenda including through the assistance from multilateral development institutions, in particular the IMF SMP.

In 2020 Australia provided support to PNG, responding to a request from PNG for financial assistance to tackle serious fiscal shortfall and cash flow issues, worsened by low commodity revenue and COVID-19 impacts. As the effects from COVID have dragged on, PNG continues to have significant economic vulnerabilities, exacerbated by the pressures of the pandemic. It is in Australia's interests to assist the Government of PNG to continue delivering core government services such as healthcare and education, and to support PNG's economic reform agenda.

Providing this loan in support of a fiscal reform effort, led by the IMF through its Staff-Monitored Program, will continue to strengthen our bilateral relationship underpinned by the Comprehensive Strategic and Economic Partnership of 2020. The CSEP provides an enduring and overarching framework for deepening bilateral cooperation across security, trade and investment, governance, development cooperation, health, education, gender equality, climate change, people-to-people and institutional links, underpinned by a commitment to achieving concrete outcomes by 2030.

Nature and terms of the Loan Agreement

On 10 December 2021, Australia and PNG entered into a 20-year loan following a request from the PNG Prime Minister, Mr James Marape to support PNG in coping with the continued economic impact of the COVID-19 pandemic. The new loan represents Australia's continued commitment to helping PNG towards more sustainable macroeconomic policy settings and reducing longer-term vulnerability.

The total principal of the loan is \$650 million Australian dollars with the base interest rate set at the 10-year Australian Government bond rate as at the date 10 business days before a date nominated by PNG to drawdown the loan, being 1.645 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 provided on a full cost recovery basis 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.