

Chapter 1. Introduction

The Independent Advisory Group (IAG) welcomes the opportunity to review the Central Banking Act (CBA). We work from the position that the Central Banking Act of 2000 was an important reform, but that 20 years on we should learn from experience to see how the Act can be improved, and the independence, accountability, transparency and effectiveness of the Bank of Papua New Guinea strengthened.

In particular, we note that the Central Banking Act 2000 was written based on “best practice” with the aim of restoring stability to the Bank of PNG and with reference to developed countries’ experience. While this certainly led to real improvements, three changes that have since occurred guide the outlook of the IAG.

First, international best practice has changed, and Papua New Guinea needs to change with it. In particular, the international trend in central bank governance is towards separation of governance and management responsibilities, enhancing accountability and transparency, and towards collegial rather than individual decision making.

Second, the experience of the last twenty years shows that we need to take into account PNG’s unique circumstances and economic structure. Papua New Guinea’s conditions are very different from those of a developed country, and the central banking legislation needs to be made “fit for purpose” for PNG. Only by combining both international and PNG-specific lessons will we be able to forge institutions that are both robust, appropriate and relevant to current and future challenges.

Third, a holistic view is required. The Bank of Papua New Guinea is a critical organisation for PNG’s economy. Not only does it set monetary policy as conventionally defined in other countries, but it also has a key role to play with regards to the exchange rate policy, government financing and banking and, of course, financial sector regulation. While we defer consideration of financial sector regulation to the second phase of this review, we consider all its other roles in this phase.

The IAG was established by the Treasurer, the Hon. Ian Ling-Stuckey. Mr Robert Igara, former Chief Secretary is the Chair. Sir Wilson Kamit, former Governor of the Bank of Papua New Guinea and Professor Stephen Howes, Director, Development Policy Centre, Australian National University are the other two members.

The IAG wrote an Issues Paper (attached as Annex 2) that was released on 30 August 2021, published it on its website (<https://pngcentralbankactiag.org/>) and circulated it to interested stakeholders. The IAG earlier circulated a draft version of the Issues Paper to Treasury and BPNG on July 21. Treasury’s response was received on 20 September and BPNG’s on 22 September. Written responses to the published Issues Paper were received from: Bank of South Pacific (BSP), Kina Bank, Brian Gomez, Dr Eugene Ezebilo (National Research Institute), the Reserve Bank of Australia, and the International Monetary Fund (IMF). Consultations were held with: Treasury, the Treasurer and the Treasurer’s Office, the BPNG Governor and senior management, BPNG board members, BSP, Kina, Reserve Bank of New Zealand (RBNZ), the New Zealand Treasury, the IMF, Teacher’s Savings and Loan Societies (TISA), the Business

Council of PNG, and Credit Corporation. We have also benefited from a report prepared by Deloitte for BPNG on BPNG governance.¹

We discussed our draft report with the Treasurer's Office and with the Bank of Papua New Guinea. We received written comments on the draft report from the Treasury, BPNG and the IMF. We thank all who provided advice, comments and feedback to the IAG.

The IAG was assisted in its deliberations by a Secretariat in the Treasury, and by a team of economists from the University of Papua New Guinea (UPNG) and The Australian National University (ANU). We would like to sincerely thank Dek Joe Sum (ANU and UPNG); as well as: Sioni Ioa, Ephraim Feto, Josephine Varpin, William Hamilton, Tim Robinson (Treasury); Dr Misty Boiloloi and Paul Flanagan (Treasurer's Office); Maholopa Laveil, Jollanda Matthew and Kelly Samof (UPNG); and Rubayat Chowdhury, Rohan Fox and Thomas Wangi (ANU).

The views expressed in this report are only of the Independent Advisory Group.

1.1 Original terms of reference (TOR)

The terms of reference for the IAG's review were set out by the Treasurer on 13 May 2021, are attached as Annex 1, and are summarised below.

1. Objectives

Review whether the objectives of the Central Banking Act 2000 give adequate priority to the growth and development of PNG, and in managing national economic crises (Section 7).

2. Governance

Review the current economic in particular monetary policy governance and management mandate of the central bank, including whether the Board or another similar body should have responsibility under the Act for determining monetary policy (sections 7-14, focusing on section 10).

3. Financing

Review the current arrangements around advances and financing to the government by the Central Bank, including a review of the TAF and options around quantitative easing options during a declared emergency (focus on Section 55).

4. Accountability and transparency

Review the institutional governance and management of the Central Bank whether there is a need for strengthened accountability and transparency, and management performance and terms, in line with international norms (sections 15-36, and sections 42-50 with potentially new sections).

¹ The IMF has prepared a "Safeguards Assessment" for BPNG, which includes recommended changes to the CBA. BPNG has shared with us the IMF's recommendations for changes to the CBA, but is not allowed by the IMF to share with the IAG (or, oddly, with Treasury) the IMF report, including the rationale for such changes.

5. Other issues

Recommend from the findings and conclusions under TOR 1-4 critical strategic issues requiring in-depth analysis and development – this will form the basis of the TOR for the second stage of the review and cover broader issues covering regulation of the financial system, actions to encourage competition, and follow-on work in light of the recent Financial Sector Reform review.

1.2 Terms of reference as addressed by the IAG and report structure

Crisis management is covered by two TOR items, 1 and 3. Under 1, the IAG is asked to review whether BPNG objectives need to be extended to cover crisis management. Under 3, the IAG is asked to examine quantitative easing options during a crisis. For clarity, it is proposed to combine these as a single, separate item relating to crisis management. TOR items 2 (governance) and 4 (accountability and transparency) are closely related, and it is also proposed to address these together. We also think it is best to consider the objectives of the Bank at the end of the report, after all relevant information has been considered, rather than at the beginning.

Thus the revised presentation of the Terms of Reference, in the order in which we deal with the various topics in the report, is:

- Governance, accountability and transparency
- Financing
- Crisis management
- Objectives
- Second-phase issues

There is no change in substance between the original and these proposed TOR. The changes are only for the sake of clarity. The report is structured as follows:

[Executive Summary](#)

[Chapter 1: Introduction](#)

[Chapter 2: Governance, accountability and transparency](#)

[Chapter 3: Financing](#)

[Chapter 4: Managing national economic crises](#)

[Chapter 5: Objectives](#)

[Chapter 6: Second phase issues](#)

[Chapter 7: Recommendations](#)

The report has a strong focus on monetary policy, with financial sector policy reserved for the second phase of our work. Monetary policy can be defined either narrowly (to cover instruments such as reserve requirements, open market operations, and policy rates) or broadly (as equivalent to macroeconomic policy, and including exchange rate policy). In PNG, exchange rate policy is the responsibility of BPNG, and Section 58 requires it to be set through the Bank's Monetary Policy Statements. In this report, therefore, we define monetary policy in the broader sense of referring to the macroeconomic policies for which BPNG is responsible.