

2011 NATIONAL BUDGET

VOLUME 1

ECONOMIC AND DEVELOPMENT POLICIES

For the year ending 31st December, 2011

**PRESENTED BY
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MINISTER FOR TREASURY & FINANCE, AND PUBLIC SERVICE
ON THE OCCASION OF THE PRESENTATION OF 2011 NATIONAL BUDGET**



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MINISTER FOR TREASURY & FINANCE, AND PUBLIC SERVICE

FOREWORD

It is a great honour for me to deliver the 2011 National Budget and the 2010 Supplementary Budget. These Budgets reflect the Government's ongoing commitment to building the foundation for economic growth and prosperity.

2010 has been a good year for Papua New Guinea. The economy is expected to grow strongly at 7.1 per cent in 2010 supported by favourable commodity prices and strong domestic demand. This has seen the Government report in its Mid-Year Economic and Fiscal Outlook Report (MYEFO) an expected budget surplus of K533.3 million in 2010. Since MYEFO the Government expects to collect an additional K120.0 million, bringing the revised Budget surplus to K653.3 million in 2010.

The Government foreshadowed at MYEFO that it would prepare a Supplementary Budget to use this surplus to fund a range of unfunded expenditure pressures and high priority initiatives. In fulfilling this undertaking, the Government will deliver a 2010 Supplementary Budget of K653.3 million while still ensuring a balanced budget in 2010.

Looking ahead to 2011, the 2011 National Budget is being delivered amid complex economic circumstances for Papua New Guinea and the rest of the world. The 2011 National Budget is being delivered in the midst of a recovering global economy but uncertainties remain. Domestically, our economy remains very resilient and while it faces challenges, we cannot understate the opportunity the PNG LNG project offers to transform our economy and substantially improve our socio-economic development.

In 2011, the economy is expected to grow at a very strong 8.0 per cent. A significant factor underpinning this forecast is the assumption of strong mining activities and the increase in construction associated with the PNG LNG project, which will have a direct impact on the construction and transport sectors. The PNG LNG project is also expected to provide a significant boost to activity in other sectors of the economy, with rising incomes and consumption from businesses and households. Inflation in 2011 is expected to increase and be relatively high at 8.2 per cent. With risks to the upside, the Government will be monitoring inflation very closely.

Within this economic outlook, the 2011 National Budget is a balanced budget with record spending totaling K9,328.1 million. The Government's highest priority is implementing the new *Medium Term Development Plan (MTDP) 2011-2015*, which will underpin the achievement of the objectives set out in the *PNG Development Strategic Plan (DSP) 2010-2030*, and *PNG Vision 2050*.

The Government remains committed to advancing development across the country, particularly through its continued efforts to transforming the rural economy. In light of the transformation that is underway in the economy and the planning and policy framework to support it, the theme for the 2011 National Budget is ***"Building the Foundation for Economic Growth and Prosperity"***.

Major initiatives announced in the 2011 National Budget include:

- Increasing Development Budget funding to historically high levels to fund high priority rural intervention programs in infrastructure, agriculture, health, law and order and education sectors;

- Increasing the Recurrent Budget to support MTDP enablers, accommodate transfers from the Development Budget and meet government obligations, including PNG LNG project related commitments;
- Announcing a series of taxation policy measures to further improve efficiency and effectiveness of our taxation system;
- Building the economy through sustained reforms; and
- Providing a framework to manage future revenues arising from the PNG LNG project.

The 2011 National Budget is fiscally responsible. It is focused on the policy-priorities of the nation as reflected in the MTDP, the DSP and the Vision 2050. Spending is being shifted to high policy-driven development priority areas to underpin the implementation of these important plans. The Government is also moving to introduce measures that will impose more discipline and control over the Government's payroll.

The 2011 National Budget also establishes a framework for stronger economic growth in PNG by building on past reforms and announcing the establishment of a coordinated and integrated Papua New Guinea Sovereign Wealth Fund to support the management of future windfall revenues to underpin the long-term social and economic development in PNG.

Much work will need to be undertaken in 2011 to give effect to the Government's decision on the Sovereign Wealth Fund but this announcement reflects the substantial efforts of the Department of Treasury, Bank of Papua New Guinea and Department of Public Enterprises in 2010, which arose following the discussion initiated by the Department of Treasury in the 2010 National Budget.

The 2011 National Budget continues the Government's efforts to build the foundation for economic growth and prosperity. This Budget will deliver a better future for Papua New Guineans.

I commend the 2011 National Budget and the 2010 Supplementary Budget to Honourable Members and to the people of Papua New Guinea.

HON. PETER O'NEILL, CMG MP
Minister for Treasury & Finance, and Public Service

CONTENTS

CHAPTER 1. BUDGET OVERVIEW.....	1
1.1 ECONOMIC OUTLOOK	1
1.2 2011 BUDGET STRATEGY AND FISCAL OUTLOOK.....	2
1.3 STATUS OF TRUST ACCOUNTS.....	2
1.4 PUBLIC DEBT	3
1.5 TAXATION MEASURES	3
1.6 ECONOMIC REFORMS.....	3
1.7 DEVELOPMENT STRATEGY	4
1.8 ECONOMIC AND FISCAL ANALYSIS OF THE PNG LNG PROJECT	5
1.9 THE ESTABLISHMENT OF A SOVEREIGN WEALTH FUND	5
CHAPTER 2. ECONOMIC OUTLOOK.....	7
2.1 INTERNATIONAL ECONOMIC OUTLOOK	7
2.2 DOMESTIC ECONOMIC OUTLOOK.....	15
2.3 GROSS DOMESTIC PRODUCT	16
2.4 LABOUR MARKET	22
2.5 PRICES.....	25
2.6 MONETARY DEVELOPMENTS.....	30
2.7 BALANCE OF PAYMENTS AND INTERNATIONAL PRICES	32
2.8 RISKS TO THE ECONOMIC AND FISCAL OUTLOOK.....	35
CHAPTER 3. 2011 BUDGET: REVENUE AND GRANTS.....	37
3.1 2011 BUDGET OVERVIEW	37
3.2 FISCAL STRATEGY.....	37
3.3 REVENUE AND GRANTS.....	38
3.3.1 Revenue Estimates Disaggregation.....	39
3.3.2 Grants	42

3.4	MEDIUM TERM FISCAL OUTLOOK.....	43
3.4.1	Revenue and Grants.....	43
3.4.2	Revenue.....	44
3.4.3	Tax Revenue.....	45
3.4.4	Non-Tax Revenue.....	45
3.4.5	Grants	46
CHAPTER 4.	2011 BUDGET: EXPENDITURE AND FINANCING	47
4.1	OVERVIEW	47
4.2	RECURRENT BUDGET	47
4.2.1	Personnel Emoluments.....	50
4.2.2	Goods and Services.....	52
4.3	NON-FINANCIAL INSTRUCTIONS	56
4.4	INTEREST AND OTHER FEE PAYMENTS	59
4.5	DEVELOPMENT EXPENDITURE.....	60
4.6	FINANCING.....	61
4.6.1	External Financing.....	61
4.6.2	Domestic Financing.....	61
4.7	PUBLIC DEBT	61
4.7.1	Domestic Debt	62
4.7.2	External Debt.....	62
4.8	2010 SUPPLEMENTARY BUDGET	64
4.8.1	UBSA/LBBSA commitments and other LNG related expenses.....	66
4.8.2	Road maintenance.....	66
4.8.3	Government Administration & Services.....	67
4.8.4	Business Investment.....	67
4.8.5	Miscellaneous.....	67

CHAPTER 5. STATUS OF TRUST ACCOUNTS	68
5.1 OVERVIEW	68
5.2 SUMMARY OF TRUST ACCOUNT MOVEMENTS	68
5.3 APPROPRIATION FOR TRUST ACCOUNTS: 2010 - 2011	69
5.4 TRUST ACCOUNT FUND MOVEMENTS IN 2010.....	71
5.5 DISTRICT SERVICE IMPROVEMENT PROGRAM TRUST ACCOUNTS	75
CHAPTER 6. TAXATION MEASURES.....	79
6.1 OVERVIEW	79
6.2 TARIFF REDUCTION PROGRAM	79
6.3 HOUSING TAX CONCESSIONS	80
6.3.1 Employer Assistance to Purchase a First Home	80
6.3.2 Increase Housing Thresholds and Benefits	80
6.3.3 Increase Stamp Duty Exemption Threshold for First Home Buyers.....	81
6.4 ENVIRONMENTAL AND SOCIAL TAX MEASURES.....	81
6.4.1 Environmental Expense Tax Deductions	81
6.4.2 Reduction in Alcohol Content of Concessional Excise	82
6.5 ENHANCEMENT OF TAX COMPLIANCE FOR SALARY AND WAGES TAX	82
6.6 ENHANCEMENT OF RETIREMENT SAVINGS ACCOUNTS.....	82
6.7 MINOR POLICY AND TECHNICAL AMENDMENTS.....	82
6.8 AREAS OF POLICY DEVELOPMENT IN 2011.....	83
CHAPTER 7. BUILDING THE ECONOMY THROUGH SUSTAINED REFORMS.....	85
7.1 OVERVIEW	85
7.2 PUBLIC SECTOR REFORM.....	85
7.2.1 The Papua New Guinea Vision 2050.....	85
7.2.2 The Public Expenditure Review and Rationalization Program.....	87
7.2.3 Equitable Resource Allocations to Provincial Governments	89

7.2.4	District Treasury Roll-out Program.....	90
7.2.5	PNG's Second Trade Policy Review.....	90
7.3	A COMPETITIVE AND DYNAMIC PRIVATE SECTOR.....	91
7.3.1	Enhancing Competition and Economic Regulation	91
7.3.2	Economic regulation (ICCC reviews)	92
7.3.3	Improving Public Infrastructure	93
7.3.4	Establishing Effective Markets	93
7.3.5	Reducing Impediments to Business and Investment.....	94
7.3.6	Improving the performance of SOEs and Statutory Authorities	95
7.3.7	Community Service Obligation policy for SOEs.....	95
CHAPTER 8.	DEVELOPMENT STRATEGY	96
8.1	2011 DEVELOPMENT BUDGET STRATEGY	96
8.1.1	Overview	96
8.1.2	MTDP 2011 -2015 and Budget alignment.....	96
8.1.3	Balancing spending across MTDP sectors	98
8.1.4	Relationship between Government and Donor Expenditure.....	99
8.2	DEVELOPMENT BUDGET 2011	99
8.2.1	Overview	99
8.2.2	MTDP Development Budget allocation: Government contribution.....	101
8.2.3	MTDP Development Budget allocation: Development Partners' contribution	103
8.2.4	MTDP Recurrent and Development Budget Allocation	104
8.3	MONITORING DEVELOPMENT	105
8.4	FUTURE DEVELOPMENT BUDGETS AND STRATEGIES	105
8.4.1	MTDP 2011 -2015.....	106
8.4.2	MDG Hotspots	106
8.4.3	Strengthening Institutional Capacity to Deliver Services.....	107

CHAPTER 9. SECTORAL POLICIES.....	108
9.1 MEDIUM TERM DEVELOPMENT PLAN ENABLERS	108
9.1.1 Land.....	108
9.1.2 Law and Justice.....	109
9.1.3 Transport.....	112
9.1.4 Higher and Technical Education	115
9.1.5 Primary and Secondary Education	117
9.1.6 Utilities	118
9.1.7 Primary and Preventative Health	123
9.2 ECONOMIC SECTORS	125
9.2.1 Agriculture.....	125
9.2.2 Fisheries.....	126
9.2.3 Forestry.....	128
9.2.4 Tourism.....	129
9.2.5 Oil and Gas	130
9.2.6 Mining Sector.....	131
9.2.7 Manufacturing.....	133
9.3 CROSS-CUTTING	134
9.3.1 Environment.....	134
9.3.2 HIV/AIDS	135
CHAPTER 10. MEDIUM TERM DEBT STRATEGY	137
10.1 OVERVIEW	137
10.1.1 Objective and Context	137
10.1.2 The Updated Debt Strategy.....	137
10.2 MAINTAINING DEBT AT SUSTAINABLE LEVELS.....	137
10.3 REDUCING FINANCIAL RISKS	138

10.3.1	Foreign Currency Risk.....	138
10.3.2	Interest Rate Risk.....	139
10.3.2	Refinancing Risk.....	140
10.3.3	Operational Risk.....	141
10.4	LONGER-TERM IMPROVEMENTS.....	141
CHAPTER 11.	UPDATE TO ECONOMIC AND FISCAL IMPACT OF PNG LNG	142
11.1	OVERVIEW	142
11.2	THE DIRECT IMPACT ON THE PNG ECONOMY	142
11.3	THE INDIRECT IMPACT ON THE PNG ECONOMY	144
11.4	THE IMPACT ON THE BALANCE OF PAYMENTS.....	145
11.5	REVENUE IMPACT AND DISTRIBUTION OF BENEFITS	146
CHAPTER 12.	THE ESTABLISHMENT OF A SOVEREIGN WEALTH FUND.....	148
12.1	OVERVIEW	148
12.2	ECONOMIC CONSIDERATIONS	148
12.2.1	Monetary Policy	149
12.2.2	Exchange Rate Issue/Dutch Disease	149
12.2.3	Fiscal Policy – Absorptive Capacity of the Economy	150
12.3	ESTABLISHING AN OFFSHORE SOVEREIGN WEALTH FUND (SWF)	151
12.4	MAJOR IMPEDIMENTS OF ONSHORE FUNDS	152
12.5	DESIGN OF SOVEREIGN WEALTH FUND/S	152
12.5.1	Objectives of a SWF in PNG	153
12.5.2	Recommended SWF Model for PNG	153
12.5.3	Next Steps.....	154
APPENDIX 1:	REVENUE TABLES	157
APPENDIX 2:	GRANTS AND TRANSFERS TO PROVINCES.....	162
APPENDIX 3:	ECONOMIC AND FISCAL DATA TABLES.....	165

FIGURES

Figure 1: World Economic Growth Projections.....	7
Figure 2: IMF All Commodity Price Index.....	10
Figure 3: PNG Export Weighted Index.....	10
Figure 4: Copper Prices.....	11
Figure 5: Copper prices and stocks	11
Figure 6: Oil prices.....	12
Figure 7: Oil Prices - Long Term.....	12
Figure 8: Oil prices against stocks	12
Figure 9: Gold Prices	13
Figure 10: Tale of Two Gold Booms.....	13
Figure 11: PNG Export Weighted Agriculture Price Index	14
Figure 12: Price Index of Key PNG cash crops	14
Figure 13: Imported Weighted Trade index.....	15
Figure 14: Exchange Rate Developments	15
Figure 15: Comparative Economic Growth in 2009	16
Figure 16: Economic Growth 1999- 2015.....	17
Figure 17: Contribution to growth by sectors, 2010 and 2011	20
Figure 18: Declining oil production over the medium term	22
Figure 19: Employment Index.....	23
Figure 20: Total Employment growth	23
Figure 21: Industry Employment growth - Year to June quarter 2010.....	23
Figure 22: Mining and Non-Mining employment.....	24
Figure 23: Minimum Wages	25
Figure 24: Consumer Price Index, through-the-year growth	26

Figure 25: Through-the-year CPI by group.....	27
Figure 26: Through-the-year CPI by Region.....	27
Figure 27: Tradable and Non-Tradable Inflation, 2001-2010.....	27
Figure 28: Actual and Projected inflation; 2010-2011.....	29
Figure 29: Nominal and Real Interest Rates.....	31
Figure 30: Money supply and Private Sector credit growth.....	31
Figure 31: Drivers of the Current Account Balance 2005-2010.....	32
Figure 32: International Reserves (Kina Million)	34
Figure 33: Projected Current Account Balance.....	34
Figure 34: Total Revenue and Grants	44
Figure 35: Mineral and Non-Mineral Revenue.....	44
Figure 36: Tax and Non Tax Revenue.....	45
Figure 37: Public Debt 2005 - 2015 (Per cent of GDP)	62
Figure 38: Currency Composition of Government Debt 2004 - 2014 (Kina Millions)	140
Figure 39: Composition of Domestic Debt 2004 - 2014 (Kina Millions)	140
Figure 40: Direct and Indirect Impact on Real GDP	143
Figure 41: Direct and Indirect Impact on Nominal GNI	144
Figure 42: Impact on Current Account Balance	145
Figure 43: Distribution of Annual Revenue within PNG	146
Figure 44: ACIL Tasman modeled the impact of PNG LNG project in the Agricultural Sector (%)	150
Figure 45: The relationship between the three funds.....	154

TABLES

Table 1: Revenue Summary Table 2009– 2011 (Kina Million)	38
Table 2: Tax Revenue 2009-2010 (Kina Million)	39
Table 3: Taxes on Income and Profits 2009– 2011 (Kina Million)	40
Table 4: Domestic Taxes on Goods and Services 2009-2011 (Kina Million)	40
Table 5: Taxes on International Trade 2009– 2011 (Kina Million)	41
Table 6: Non-Tax Revenue 2009 – 2011 (Kina Million)	41
Table 7: Grants by Sources (Kina Million)	43
Table 8: Total Expenditure and Net Lending 2009–2011 (Kina Million)	47
Table 9: Recurrent Expenditure 2009–2011 (Kina Million)	50
Table 10: Personnel Emoluments 2009–2011 (Kina Million)	51
Table 11: Personnel Emoluments – National Departments by Items 2009–2011 (Kina Million)	52
Table 12: Goods and Services 2009–2011 (Kina Million)	52
Table 13: National Departments Goods and Services 2009–2011 (Kina Million)	53
Table 14: General Goods and Services by Item 2009–2011 (Kina Million)	53
Table 15: Provincial Goods and Services Grants 2009–2011 (Kina Million)	54
Table 16: Transfers to Autonomous Bougainville Government 2009 -2011 (Kina Million)	54
Table 17: Transfers to Statutory Authorities 2009– 2011 (Kina Million)	55
Table 18: Interest & Other fee Payments 2009 – 2011 (Kina Million)	59
Table 19: Development Expenditure: By Source 2009–2011 (Kina Million)	60
Table 20: 2010 Supplementary Budget Allocation (Kina Millions)	64
Table 21: PNG LNG UBSA related Commitments (Kina Millions)	66
Table 22: Summary of Trust Accounts movements since 2005– 2010 (Kina Million)	68
Table 23: Trust Account appropriations and payments 2010- 2011 (Kina Million)	69
Table 24: Trust Account Movements from 1 January to 30 September 2010 (Kina Million)	71
Table 25: Movement of the 89 DSIP Bank Accounts from 1 January to 30 September 2010 (Kina)	76

Table 26: Tariff Reduction Program: 2012 - 2018	80
Table 27: Prescribed housing thresholds	81
Table 28: 2010 and 2011 Development Budget (Kina Million)	100
Table 29: Government Fixed Commitments (Kina Million)	100
Table 30: Government direct financed projects/programs K40 million & above (Kina Million)	101
Table 31: 2011 GoPNG direct financing: MTDP and non-MTDP expenditure (K' Million)	102
Table 32: GoPNG's 2011 Development Budget contribution to MTDP enablers	102
Table 33: 2011 GoPNG Development Expenditure on non-MTDP priority areas (Kina Million)	102
Table 34: 2011 Development Partners' grant financing: MTDP & non-MTDP expenditure (Kina Million)	103
Table 35: Development Partners' grant contribution to MTDP enablers	104
Table 36: 2011 Go PNG Total Expenditure Versus Donor Expenditure (Kina Million)	104
Table 37: MTDP estimated resource envelope (K'billion)	106
Table 38: Development Appropriations for Land 2005-2011 (Kina Million)	109
Table 39: 2011 Development Expenditure on Land (Kina Million)	109
Table 40: Development Appropriations for Law and Justice 2005-2011 (Kina Million)	111
Table 41: 2011 Development Expenditure on Law and Justice (Kina Million)	111
Table 42: Development Appropriations for Transport 2005-2011 (Kina Million)	114
Table 43: 2011 Development Expenditure on Transport (Kina Million)	115
Table 44: Development Appropriations for Higher and Technical Education 2005-2011 (K' Million)	116
Table 45: 2011 Development Expenditure on Higher and Technical Education (K' Million)	116
Table 46: Development Appropriations for Primary and Secondary Education 2005-2011 (Kina Million)	118
Table 47: 2011 Development Expenditure on Primary and Secondary Education (K' Million)	118
Table 48: Development Appropriations for Water and Sanitation 2005-2011 (Kina Million)	120
Table 49: 2011 Development Expenditure on Water and Sanitation (Kina Million)	120
Table 50: Development Appropriations for Energy Development 2005-2011 (Kina Million)	121
Table 51: 2011 Development Expenditure on Energy Development (Kina Million)	121

Table 52: Development Appropriations for ICT 2005-2011 (Kina Million)	123
Table 53: 2011 Development Expenditure on ICT (Kina Million)	123
Table 54: Development Appropriations for Primary and Preventative Health 2005-2011 (Kina Million)	125
Table 55: 2011 Development Expenditure on Primary and Preventative Health (Kina Million)	125
Table 56: Approximate Composition of Domestic Debt by Instrument	139

CHAPTER 1. BUDGET OVERVIEW

1.1 ECONOMIC OUTLOOK

In line with the global economic recovery, world commodity prices have continued to rebound from the large falls observed in late 2008 and early 2009. These stronger prices have been positive for the PNG economy, translating into improved profitability for businesses and higher Government revenue. Commodity prices have recently experienced a strong surge with some prices moving into record uncharted territory and others back to peak levels prior to the global financial crisis. However, commodity prices remain volatile as financial markets seek clear directions from an unusually uncertain global environment.

Domestically, the PNG economy is expected to rebound and grow very strongly at 7.1 per cent in 2010, driven by the commencement of the PNG LNG project, supported by improvements in the global environment. The PNG LNG project is already having a positive impact on the economy, particularly in the transport and construction industry. Indirectly, other sectors are benefiting through the provision of goods and services to the contractors and through an increase in consumer spending. The outlook for 2011 is very positive, with the PNG economy forecast to grow by 8.0 per cent, which represents 10 years of uninterrupted economic growth. The forecast acceleration in growth is largely driven by the expected ramp up in PNG LNG construction activity and stronger mining and agricultural production in 2011.

Over the medium term, economic growth is projected to ease, especially in 2013 when the PNG LNG construction phase winds down. In addition, the declining production from the maturing oil fields and the slowdown of activity at Ok Tedi as it moves to closure in 2014 (pending expansion plans) will have a negative impact on growth. In 2014 and 2015, LNG production is expected to come on line, providing a very large boost to GDP growth.

The economy is increasingly seeing signs of capacity constraints after a long period of economic expansion with national infrastructure such as roads, ports and utilities strained by increased use and poor maintenance in the past. Businesses are also facing increasing difficulties in finding suitable labour and land. This is now translating into bottlenecks, with strong wages growth and a rapid increase in the cost of using and developing land. Inflation is at a relatively high level with inflation forecast to be 6.0 per cent in 2010. Inflation is then estimated to rise to 8.2 per cent in 2011, with substantial risks to the upside. This is largely driven by the ramp up in PNG LNG construction activity and high Government expenditures, which are expected to put additional strains on scarce resources in the economy.

The following factors present a risk to the economic and fiscal outlook presented in the Budget:

- The fragility of the global economy poses a key risk to PNG in terms of its impact on the demand for PNG exports and commodity prices.
- Delays to the PNG LNG and other mining projects due to land owner issues.
- The Government diverting from fiscal discipline and adding to already strong inflationary pressures.
- On the upside, there are currently a number of mining and gas projects (such as the second LNG project) which are currently under active consideration. Should these

projects proceed, this would provide a significant boost to economic growth in the near term, and a more positive revenue outlook over the longer term.

1.2 2011 BUDGET STRATEGY AND FISCAL OUTLOOK

Fiscal Strategy

The 2011 Budget is framed against a background of global economic recovery and strong domestic economic growth.

With the PNG economy in a transition phase during the construction phase of the PNG LNG project, the Government has decided on a balanced budget for 2011 to provide a stable macroeconomic and fiscal environment. This is consistent with the current high economic growth and also adheres to the existing overarching frameworks – the Medium Term Fiscal Strategy (MTFS), the Medium Term Debt Strategy (Debt Strategy), the Development Strategic Plan 2010 - 2030 (DSP), the Medium Term Development Plan (MTDP) and the *Fiscal Responsibility Act 2006*.

Both the recurrent and development budgets are focused on MTDP enablers to support the Government's aim of **Building the Foundation for Economic Growth and Prosperity** commencing 2011.

Revenue

Total revenue and grants in 2011 is estimated at K9,328.1 million. This is K1,083.6 million or 13.1 per cent higher than the 2010 revised estimate. This is primarily attributable to higher tax revenue of K850.0 million or 13.1 per cent from the revised 2010 estimate. Higher tax revenue is largely due to higher personal income and company taxes, which are increasing due to strong domestic economic growth and the ramp up in PNG LNG activity.

Expenditure

Total Expenditure and Net Lending in 2011 is estimated at K9,328.1 million. This is K1,048.7 million or 12.7 per cent higher than the 2010 revised estimate. These increases are allocated to funding MTDP enablers in the recurrent and development budgets, and unavoidable obligations such as outstanding court orders, superannuation and industrial award wage increases.

2010 Supplementary Budget

The Government also announced an additional expenditure of K653.3 million in the 2010 supplementary budget. The key expenditure items are funding for the UBSA commitments to support the LNG project and increases in road infrastructure.

1.3 STATUS OF TRUST ACCOUNTS

Trust accounts contain funds appropriated through Additional Priority Expenditure (APE), Supplementary Budget Expenditure (SBE) and Annual Budgets, predominantly from additional mineral revenue from the commodity boom of 2005 to 2008.

As at 30 September 2010, a total of K951.1 million was held in trust accounts, with outstanding appropriations for trust from the 2010 Budget of K415.0 million, K40.0 million from the 2010 Budget reappropriation and a further K552.3 million paid into trust from the

2010 Supplementary Budget. A total of K723.2 million is appropriated for trust accounts in the 2011 Budget. Total payments from trust accounts from 1 January to 30 September 2010 were K736.6 million.

1.4 PUBLIC DEBT

Total public debt increased slightly to K6,944.1 million at the end of 2009 as a result of a small budget deficit. However, debt as a per cent of GDP fell from 32.1 per cent to 31.3 per cent reflecting moderate growth in GDP.

By the end of 2010, total public debt is expected to decrease slightly due to exchange rate movements to K6,914.3 million or 26.8 per cent of GDP.

Over the 5 years to 2010, the debt to GDP ratio fell significantly and is approaching a sustainable level.

1.5 TAXATION MEASURES

The 2011 Budget introduces a number of taxation policy measures. The Government will undertake a further but modest tariff reduction program (TRP), with the aim of promoting an internationally competitive and efficient private sector, and update housing tax concessions which have been substantially eroded over time by house price inflation.

The Government will also seek to improve environmental and social outcomes by allowing tax deductions for environmental protection and clean-up costs, and reduce the alcohol content of beverages which receive concessional excise treatment.

Other taxation measures will enhance Retirement Savings Accounts and seek to improve compliance in the remittance of salary and wages taxes.

There are also a number of minor policy and technical amendments to clarify the law and administrative procedures, strengthen enforcement activities, increase administrative efficiency and correct technical errors.

There are no new taxes introduced in this budget.

1.6 ECONOMIC REFORMS

Papua New Guinea continues to benefit from past reforms. These reforms have contributed to sustained economic growth that shielded the economy from the worse effects of the recent global financial crisis and has provided a conducive environment for investment as seen with the PNG LNG project.

The Government will ensure that development policies and strategies, including existing and any new reforms in 2011, will be closely aligned with key objectives of the Vision 2050 and the Papua New Guinea Development Strategic Plan (DSP) 2010 - 2030 and Medium Term Development Plan (MTDP). This will require a clear and consistent commitment by the Government to address the underlying issues that affect service delivery and impede private sector investment and growth.

In 2011, the Government will demonstrate its commitment to public sector reform by exploring opportunities to improve service delivery and continuing with the existing public sector reform initiatives to improve the efficiency, effectiveness and affordability of the public

sector. The Government will also continue with its longstanding Public Expenditure Review and Rationalization (PERR) program.

The Government supports the development of a competitive and dynamic private sector that underpins economic growth. In recent years, the Government has undertaken various initiatives in this regard to promote and provide a conducive environment for businesses to invest and generate growth. In 2011, the Government will monitor existing reforms to ensure they achieve their objectives and explore areas for further reform. In order to provide a stable investment climate that promotes a competitive and dynamic private sector, the Government will continue to remove impediments to doing business and investment in PNG.

1.7 DEVELOPMENT STRATEGY

The 2011 Development Budget is the first annual budget of the Development Strategic Plan (DSP) 2010-2030 and the Medium Term Development Plan (MTDP) 2011-2015. The DSP is the Government's strategy for realizing long term goals and visions as enshrined in the Constitution of Papua New Guinea.

The MTDP is the first of four five-year plans to implement the DSP and it is the country's first action plan, explaining what will be done over the next five years in order to pursue the DSP goals. Following alignment of plans, sector funding will be based on implementing agencies and provincial Governments, annualising their programs and activities to achieve the desired deliverables detailed in the MTDP. Implementing agencies, sub-national Governments, and development partners will be held accountable to achieve the desired targets. As such, MTDP promotes results-based monitoring and a performance based culture throughout the public service.

The 2011 Development Budget targets high impact and productive investments aimed at providing access and opportunities to the rural majority and improving progress towards achieving the MDGs. Expenditure under the 2011 Development Budget will be directed towards all sectors of the economy however particular focus will be given to the MTDP *enablers*. Investment in the enablers will address current supply-side and absorptive capacity constraints and facilitate growth and development.

Fixed commitments, totalling K794.4 million must also be met through the Development Budget. The Development Budget strategy prioritises the remainder of Government direct financing across all sectors of the economy, with particular focus on the seven enablers. Crucially, the approach to achieve a sound foundation and progression towards becoming a middle income country by 2030 is structured around ensuring the Budget is *policy* driven and in line with MTDP priorities.

Effective implementation of the MTDP requires a significant proportion of the Budget to be allocated to MTDP priorities, and crucially to the enablers' policies. In 2011, 80.0 per cent of Government expenditure (i.e. direct financing, tax credit and loans) under the Development Budget will be expended on interventions implementing the first year of the Medium Term Development Plan. Of this percentage, 70.0 per cent will be allocated to the enablers' MTDP priorities: land, law, justice and order, transport, higher and technical education, primary and secondary education, utilities and health. Non-MTDP expenditure in 2011 includes payment of the constitutional grants, development grants, and aid administration.

Over the next five years, to fully implement the MTDP 2011-2015, the Government will strive to increase the proportion of the Budget allocated to MTDP policy objectives. To achieve this

requires Government to reduce the funding of expenditure items which are not detailed in the MTDP and closely align the Recurrent and Development Budget. Crucially, from 2011 onwards, the Government will ensure that the allocation of resources through the Development Budget is driven by policy and respective sector strategies and no longer purely expenditure driven or on an ad-hoc basis.

1.8 ECONOMIC AND FISCAL ANALYSIS OF THE PNG LNG PROJECT

The PNG LNG project will be the largest and most expensive investment in PNG to date; however, the extent of the impact on Gross Domestic Product (GDP) depends on how much of the economic activity actually occurs in PNG. Much of the project construction material will take place offshore, which does not add to the size of the domestic economy.

The major economic impact from the PNG LNG project will be felt in the first year of full production, which is expected to be 2015, providing a very large boost to GDP. Once production begins, the direct impact on GDP will be very large, as all of the value added from the project is recorded as taking place in PNG. Over the length of the project, annual gross value added is estimated to average around K2 billion in real terms. Over the peak production phase, this represents an additional 20 to 25 per cent of GDP per year, although the relative impact is expected to decline over time as the economy increases in size and as production declines towards the end of the project's life.

The project's total impact on the economy is the sum of the direct and indirect impacts. The total impact on real GDP is estimated to average around K3 billion to K3.5 billion in real terms (an increase of around 25.0 to 30.0 per cent) over the peak production phase of the project, and average around K2.0 billion to K2.5 billion per annum in real terms over the life of the project.

The major benefit of the PNG LNG project to the National Government, provincial governments and landowners is from distributions of company tax (reported as mining and petroleum tax revenue or MPT), mining royalties (including the development levy) and dividends on equity. Government revenue is expected to increase rapidly during the first 10 years of production, as the benefits of accelerated depreciation (a form of tax concession) are gradually exhausted. Revenue is then expected to be relatively stable until production starts to decline later in the life of the project.

1.9 THE ESTABLISHMENT OF A SOVEREIGN WEALTH FUND

The development of the PNG LNG project and the prospect of others will not only transform our economy and improve living standards. However, it is likely that the emergence of LNG as a major revenue source, will give rise to macroeconomic pressures which are more likely to be prevalent when a country relies heavily on commodity based revenues.

The Government has recently considered and agreed to a joint Cabinet Submission reflecting both the joint Treasury-Bank of Papua New Guinea Working Group's work and the separate work undertaken by the Department of Public Enterprises on alternative arrangements to help manage the significant revenues arising from this project to be used for PNG's development needs whilst promoting macroeconomic stability.

As a consequence, the Government has decided to establish a Sovereign Wealth Fund (SWF) consisting of a consolidated pool of offshore funds with three coordinated and integrated funds with all expenditures being through the budget process:

- A Stabilization Fund (Stabilization SWF);
- A Future (Savings) Fund; and
- An Infrastructure Fund (Infrastructure SWF).

To oversee the establishment of the offshore Sovereign Wealth Fund for PNG, the Government has established a Secretaries Committee on Sovereign Wealth Funds which will take all necessary steps to establish this important undertaking.

CHAPTER 2. ECONOMIC OUTLOOK

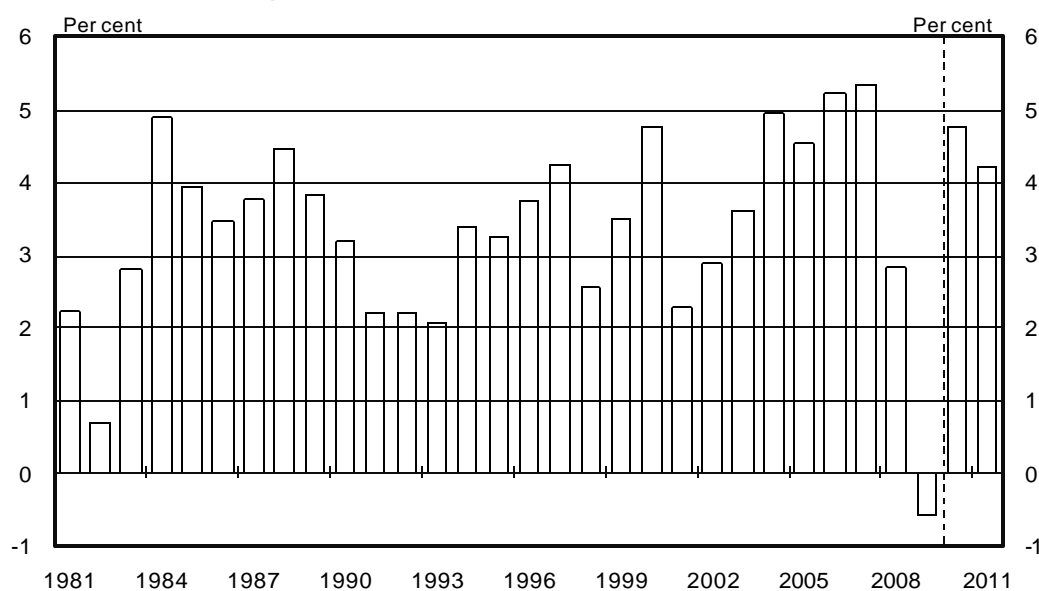
2.1 INTERNATIONAL ECONOMIC OUTLOOK

World Economic Growth

The global economic recovery in 2010 has been firmer than expected. However, a number of setbacks has made the recovery more fragile and uncertain. At the beginning of the year, there was optimism that the worst was over, owing to the strong and decisive actions by governments around the world in containing the fallout from the financial crisis. This optimism quickly evaporated in mid-May when the sovereign debt crisis broke out in the Euro area, firstly in Greece and then in Portugal, Spain, Italy and Ireland - this was a major setback and dented confidence in the sustainability and strength of the global economic recovery. Heightened market volatility and declining risk appetite induced by the selling of sovereign debt instruments in the Euro area shook banking systems in the region. Moreover, some economic data indicated that recovery in the US economy was not as strong as anticipated, increasing the chances of the US economy slipping back into another recession. There were also fears of a stronger than anticipated slowdown in China, as the Chinese Government attempted to cool overheating parts of the economy. However, despite these setbacks the global recovery has continued, driven by the emerging and developing economies, particularly China.

The International Monetary Fund (IMF) in its October 2010 World Economic Outlook (WEO) projects the global economy to expand by 4.8 per cent in 2010. This solid growth is expected to be driven by the emerging and developing countries, mainly China, India, Brazil and other Asian Economies. In advanced economies, economic growth is expected to remain slow and sluggish.

Figure 1: World Economic Growth Projections



Source: International Monetary Fund (IMF)

In 2011, world economic growth is projected to moderate slightly to 4.2 per cent. In advanced economies, growth is expected to slowdown, as fiscally-constrained governments withdraw fiscal stimulus at a time when private sector demand remains weak and may not be able to fill the void. In emerging and developing economies, economic growth is projected to moderate from the second half of 2010 and into 2011.

Advanced economies are expected to grow by 2.7 per cent in 2010. This is relatively low considering that these economies are recovering from the deepest recession since World War II. The US economy is expected to grow by 2.6 per cent in 2010, with output still well below pre-crisis levels. Much of the weakness is due to sluggish personal consumption – by far the biggest component of US GDP. There are several reasons for this weakness. First, household net worth has deteriorated sharply, due to significant falls in US housing prices. Second, unemployment is high, with the duration of joblessness continuing to lengthen. The weak labor market has affected incomes and the ability to obtain credit, and there is job uncertainty for those currently employed. Third, banks are still reluctant to lend to consumers, as they struggle to reduce leverage and restore balance sheets. In 2011, US economic growth is projected to moderate to 2.3 per cent, as consumer demand is expected to remain weak, and as the adjustment in the financial and public sectors continue.

Japan and the Euro area are expected to grow by 2.8 per cent and 1.7 per cent respectively in 2010. Output levels are also below pre-crisis levels. In Japan, the recovery has been largely driven by external demand. Growth in the Euro area picked up in the second quarter of 2010 which was led by Germany. While this presents a modest recovery, the Euro area heavy dependence on bank credit is restraining demand as banks continue to be unusually cautious in lending. Economic growth is expected to moderate in 2011, with Japan and the Euro area growing by 1.5 per cent. This reflects the winding down of policy stimulus as there is little flexibility in government finance to continue to stimulate growth, sluggish consumer demand, persistent high unemployment and weaker external demand expected from major trading partners, especially from the US.

Emerging and developing economies are expected to expand by 7.1 per cent in 2010. China continues to be the key driver of growth, with the economy's strong position before and after the crisis powering growth in the rest of Asia. Proactive policy measures implemented in response to crisis has provided the backdrop for continued strong growth in China. With the recovery well and truly on a solid footing, the economy is now in the middle of a transition from public to private sector led growth. Other strong performing emerging and developing economies include India and Brazil. Growth in emerging and developing economies is expected to moderate slightly to 6.4 per cent in 2011, largely reflecting the expected slowdown in China's rate of growth as it moves to cool some of its overheating sectors, and the winding down of policy stimulus across the region.

Going forward, for a sustained and healthy recovery to gain a more stable foothold, economies with large public deficits and debt will need to formulate a credible pathway back to fiscal sustainability. At the same time, fiscally constrained governments will need to consider the appropriate timing for withdrawal of public stimulus so as not to derail recovery efforts. The financial sector, which was at the heart of the global financial crisis in 2008, will need to continue the process of repair and reform. In addition, for a balanced recovery, both the advanced and emerging and developing economies need to work together to correct some of the external imbalances that exist in the global economy.

Over the medium term, world economic growth is projected to average 4.5 per cent per annum. This is slower than the growth witnessed in the five years leading up to the

global financial crisis and is largely due to the time needed for the earlier discussed adjustments to be implemented in both the advanced, and emerging and developing economies. Downside risks remain elevated and are a concern as markets and institutions are expected to remain fragile for some time.

Unemployment

Unemployment in advanced economies has receded only modestly from peak levels. Current estimates are that more than 210 million people across the globe are unemployed, an increase of over 30 million since 2007. Around three-quarters of the increase occurred in the advanced economies, with the remainder in emerging market economies.

In the United States, the unemployed face record-long periods of joblessness, with recent payroll data pointing to a slowdown in employment growth in the second quarter of 2010. In the Euro area, the labour market showed signs of resilience in Germany, taking into account the magnitude of the recession. However, in Spain, unemployment is not showing any signs of coming down from high levels. This has been attributed to labour market rigidities and the collapse of the construction sector. In the emerging and developing economies, unemployment has broadly declined in line with the strength of the recovery.

Inflation

Inflation in the advanced economies is projected to remain low amid concerns of high levels of excess capacity and unemployment. In 2010, inflation is forecast to be a mild 1.4 per cent, up from 0.1 per cent in 2009. In 2011, inflation is expected to remain muted at 1.3 per cent, as economic growth remains sluggish. Under present circumstances, deflation is the more pertinent risk for some of the advanced economies, as risks to activity are clearly on the downside: households remain saddled with appreciable debt; the financial system remains vulnerable; and expectations could gradually catch up to actual inflation, putting further downward pressure on prices and wages.

In contrast, inflation in emerging and developing economies has picked up quite strongly since 2009, as emerging and developing economies have rebounded much more strongly than advanced economies following the global recession. In 2010, inflation in the emerging and developing economies is forecast to be 6.2 per cent, compared to 5.2 per cent in 2009. In 2011, inflation in emerging and developing economies is expected to ease to around 5.2 per cent, as inflationary pressures ease due to the moderation in the pace of economic growth.

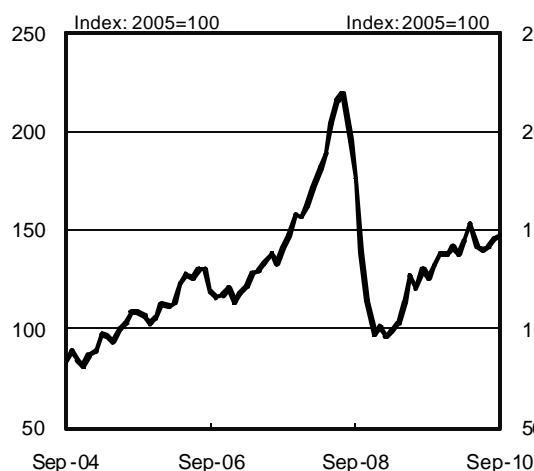
Commodity Prices

Commodity prices have experienced some sharp swings since the global financial crisis. This has been associated with an unusual degree of uncertainty in the global economy, where the recovery remains fragile and uneven. In 2010, commodity prices have continued to rebound from the large falls observed in late 2008 and early 2009. However, the path of recovery has been volatile as financial markets seek clear directions of the global economic recovery from mixed economic signals. In general, commodity prices strengthened in the beginning of the year with growing optimism in the global economic recovery. This stalled around May 2010 with the onset of the sovereign debt problems in the Euro area, combined with concerns regarding the strength of the US economic recovery and the slowdown of Chinese economic growth. Commodity prices have picked up strongly again in the second half of 2010. While some of the recent price increases can be attributed to changes in

economic fundamentals, there is a concern among some analysts and commentators that prices for some commodities have been influenced by speculative behavior and the weakening of the US dollar. In this uncertain environment, it is possible that those speculative expectations may not eventuate, which could lead to the possibility of a sizeable decline in commodity prices.

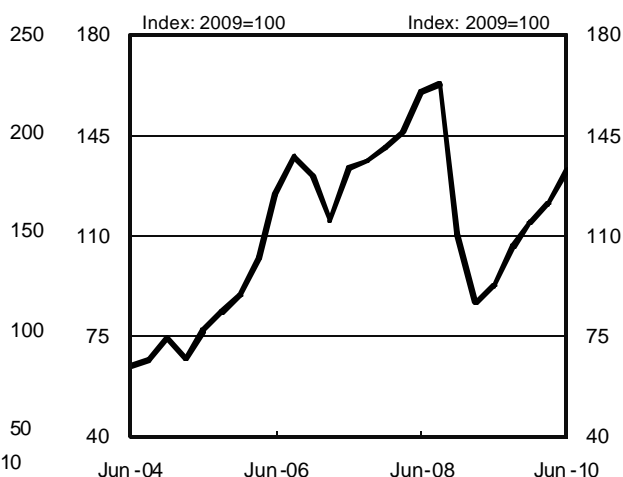
The IMF All Commodity Price Index shows that commodity prices have increased across the board (Figure 2). In September, prices increased by 4.0 per cent since the beginning of the year, and are 17.0 per cent higher compared to September 2009. However, for the PNG economy and government revenue the PNG Export-Weighted Price Index is the more relevant indicator (Figure 3). This shows that prices have increased by 9.0 per cent since the beginning of the year and are 44.0 per cent higher in the June quarter 2010 compared to the same time last year.

Figure 2: IMF All Commodity Price Index



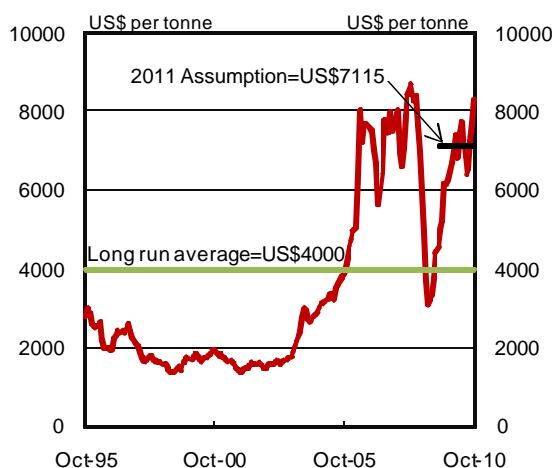
Source: IMF and Bank of Papua New Guinea

Figure 3: PNG Export Weighted Index

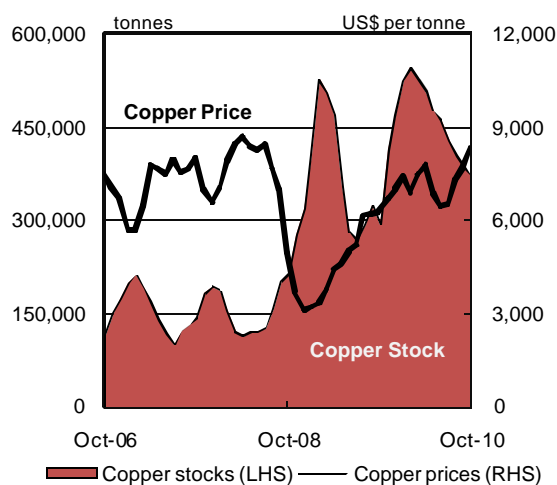


The following discussion are centered on the main mineral, petroleum and agricultural commodities that PNG exports.

Copper prices surged higher in 2010 as the global economy improved. Early in the year, copper prices peaked around US\$7,950 per tonne. As discussed earlier, the growing uncertainty surrounding the global economic recovery led to spot prices falling to US\$6,100 per tonne in June. Prices have since surged higher with spot prices trading above US\$8,500 per tonne in October (well above long-term prices), driven by weakness in the US dollar and the strong growth of capital-intensive emerging economies. To the end of October 2010, copper prices averaged around US\$7,286 per tonne, which is 41.0 per cent higher compared to the average price in 2009.

Figure 4: Copper Prices

Source: Department of Treasury & London Metals Exchange

Figure 5: Copper prices and stocks

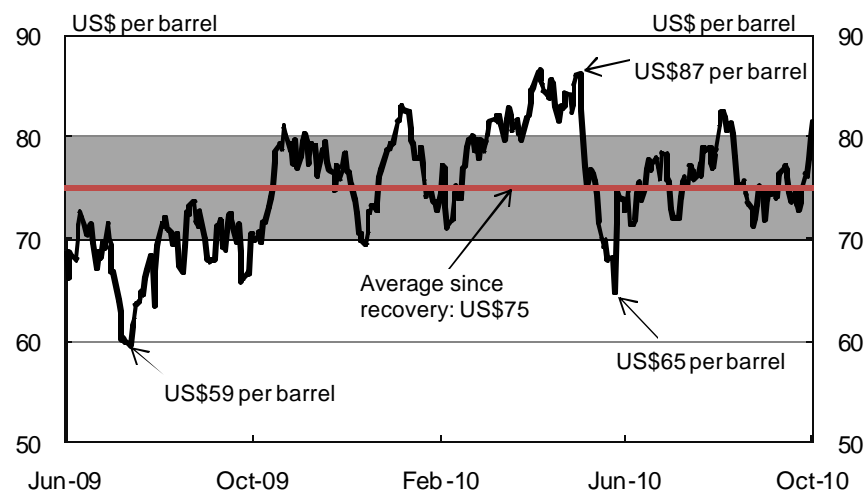
Interestingly, copper prices are now approaching the previous peaks experienced in late 2007. However, Figure 5 shows that previous peaks were associated with relatively tighter supply (as indicated by the low stock levels in the London Metals Exchange).

Copper prices are assumed to average US\$7,115 per tonne in 2011. This assumption takes into account the anticipated increase in future consumption demand, especially in emerging economies, and the possible risk of a pull back in prices due to the fragile state of the global economy.

Oil prices have also increased in 2010, rebounding from lows in late 2008 and early 2009. In 2010, oil prices increased to as high as US\$87.0 per barrel before falling to around US\$65.0 per barrel in May. Prices have since recovered, to be above US\$80.0 per barrel in October 2010. To the end of October, the West Texas Intermediate (WTI) oil prices have averaged around US\$78.0 per barrel in 2010, which is 26.0 per cent higher compared to the average price in 2009.

Figure 6 shows that prices have largely traded between US\$70.0 to US\$80.0 per barrel since the middle of 2009.

Figure 6: Oil prices



Source: Department of Treasury and US Energy Information Administration

According to Saudi Arabia, OPEC's most influential member, an oil price between US\$70.0 and US\$80.0 per barrel is ideal. In addition, non-OPEC oil producers have also increased supply, driven by high oil prices and the low cost of production. Combined with the relatively high level of oil inventory in the United States (the world's largest oil consumer – see Figure 8), this could curb any substantial price increases in the near term. In 2011, oil prices are assumed to average US\$76.0 per barrel, consistent with the price range observed in 2010.

Figure 7: Oil Prices - Long Term

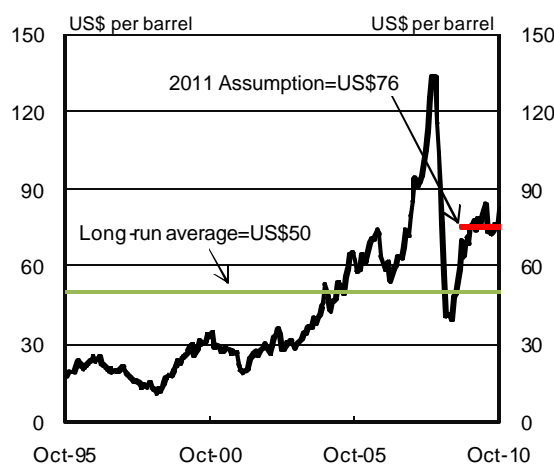
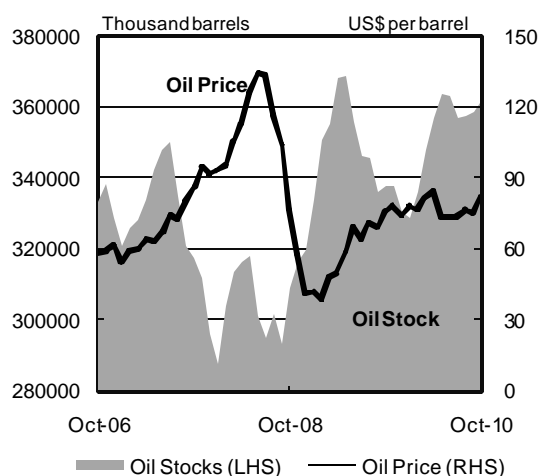


Figure 8: Oil prices against stocks



Source: Department of Treasury and US Energy Information Administration

Gold prices have continued to rise sharply in 2010 to record levels, increasing by as much as 20.0 per cent since the beginning of the year. Gold's safe haven status and the weakness in the US dollar has played a significant role in the rapid increase in gold prices, with gold trading well above US\$1,300 per ounce in October 2010. The surge in gold prices into record territory has been quite rapid. As discussed earlier, while changes in fundamentals support some of the increases in commodity prices, the strength and pace at which prices have moved in 2010 have raised concerns that a gold price bubble may be developing. To the end of October, prices have averaged around US\$1,194 per ounce in 2010, which is 23.0 per cent higher compared to the average price in 2009.

The current boom in gold prices which started in early 2004 has seen the price increase by over 200.0 per cent. As shown in the Figure 10, a similar boom in prices also occurred in the late 1970's when prices rose rapidly. However, after reaching a peak in January 1980, prices crashed, falling back very sharply. It is important that previous episodes of commodity price surges and falls are not forgotten when assessing the rapid rise in the price of some of these commodities. The gold price is assumed to be US\$1,150 per ounce in 2011, taking into account the possibility of pull back in prices should the US dollar strengthen and the world economic recovery becomes more stable.

Figure 9: Gold Prices

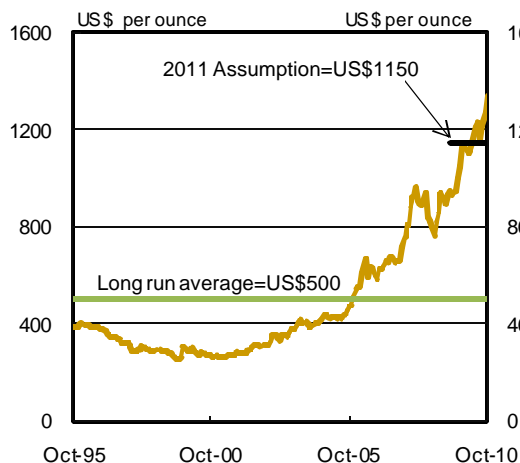
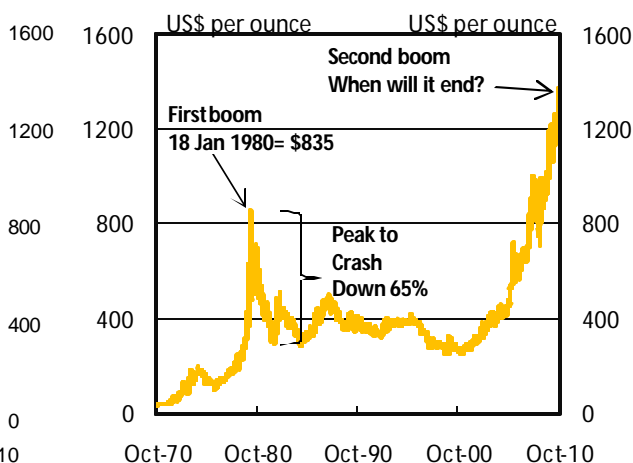
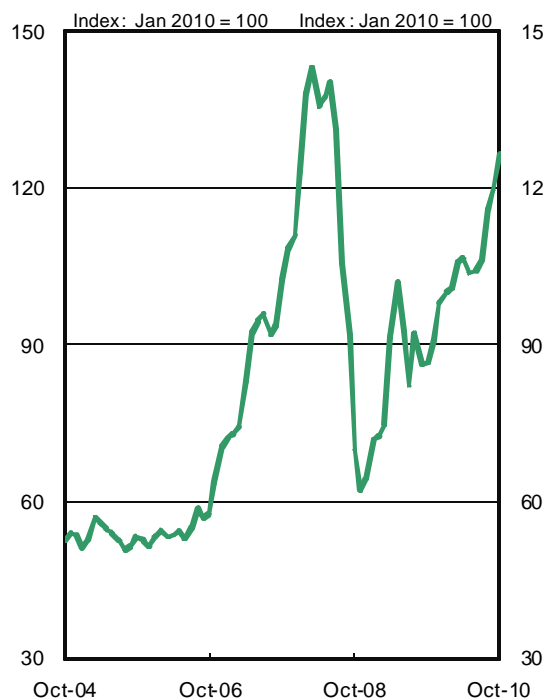
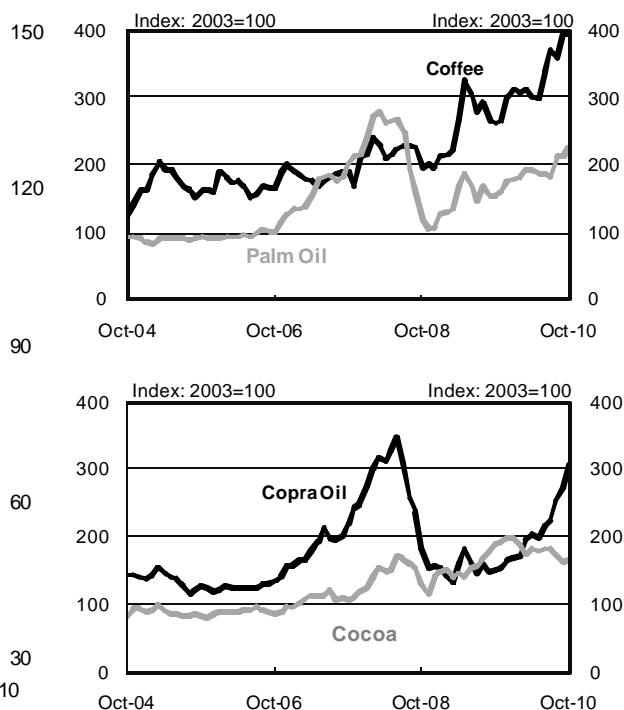


Figure 10: Tale of Two Gold Booms



Source: Department of Treasury and Bank of England;

Prices of agriculture commodities have also rebounded in the first half of 2010 and are expected to grow stronger in 2011 from their lows in late 2008 and 2009. As shown in Figure 11, the Export Weighted Agricultural Price Index, which tracks growth across key export commodities in the agriculture sector, has increased by as much as 27.0 per cent since the beginning of 2010 and is 46.0 per cent higher in October 2010 than a year earlier. The improvement in the global economy at the beginning of the year has seen demand for agriculture commodities improve significantly and this has been supported by some concerns of tight supply due to lower global agricultural stocks. This has left the market more vulnerable to supply disruptions than would have normally been the case. On average in 2010, the price of palm oil have traded around US\$808 per tonne, coffee around US\$226 per tonne, cocoa around US\$3,162 per tonne and coconut oil around US\$1,027 per tonne.

Figure 11: PNG Export Weighted Agriculture Price Index**Figure 12: Price Index of Key PNG cash crops**

Source: Department of Treasury and Reuters

There will be challenges for commodity prices to sustain strong increases in 2011, as world economic growth is expected to moderate slightly. Given the influence that commodity prices have on government revenue in PNG, the commodity price assumptions have been formulated taking into consideration the improving global economy and the aforementioned risk.

Exchange rates

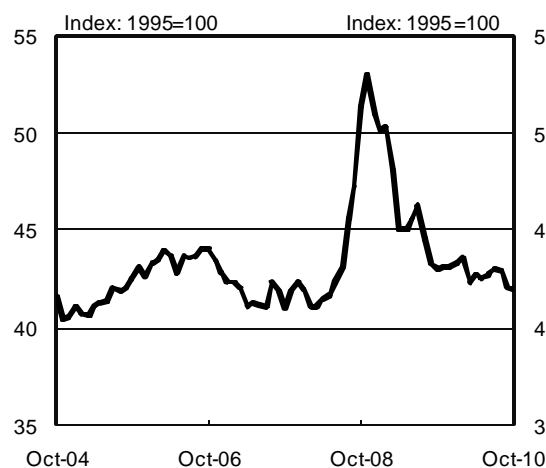
PNG's Import Trade Weighted Index (TWI) depreciated slightly by 2.5 per cent over the year to October 2010. The lower import TWI compared to the corresponding period of 2009 has been largely driven by the depreciation of the Kina against the Australian dollar, Malaysia ringgit, Japanese Yen, and Singapore dollar. The Kina depreciated by 9.0 per cent against the Malaysian ringgit, 7.5 per cent against Japanese Yen, 5.7 per cent against Australian dollar and 4.9 per cent against the Singapore dollar. This has been partially offset by the appreciation of Kina against Euro by 8.8 per cent and the US dollar by 2.0 per cent.

Against the major trading currencies, the Kina has fallen in value against the Australian dollar, driven by the strength of demand for the Australian dollar. Unlike other advanced economies, Australia did not experience a recession and has emerged from the global downturn relatively quickly, with a robust financial system and low unemployment. Furthermore, strong commodity prices and relatively high interest rates compared to other economies has made Australian denominated assets more attractive. The depreciation of

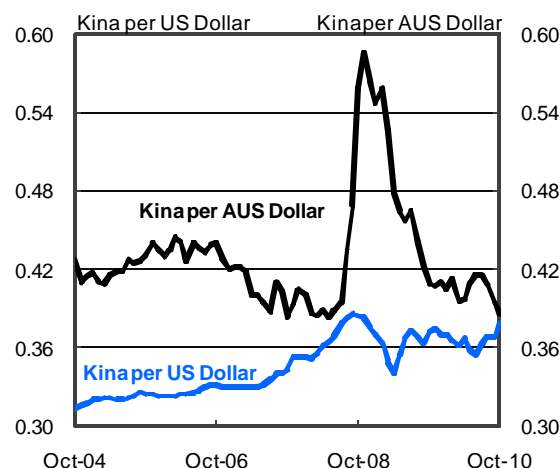
the Kina against the Australian dollar is expected to increase inflationary pressure in the PNG economy, with rising import cost passing through to higher consumer prices.

Against the US dollar, the Kina has appreciated by 2.0 per cent over the year to October 2010. This partly reflects the expectation of quantitative easing (injection of liquidity) by the US Federal Reserve, which further reduces the value of the US dollar and mining companies moving funds into PNG to meet tax obligations. The slight rise in the value of the Kina against the US dollar is likely to marginally reduce the Kina value of US denominated export earnings.

Figure 13: Imported Weighted Trade index **Figure 14: Exchange Rate Developments**



Source: Bank of PNG and Department of Treasury



Source: Bank of PNG and Department of Treasury

2.2 DOMESTIC ECONOMIC OUTLOOK

The outlook for domestic economic growth is very positive, with the PNG economy forecast to grow uninterrupted for the tenth consecutive year in 2011. This is an impressive achievement, considering that over this time there have been a number of challenges, especially with the global financial crisis in 2008 and the subsequent global recession in 2009. To a larger extent, the progress of the PNG economy can be attributed to a more stable political and macroeconomic environment. This has been supported by the Government's prudent fiscal management and microeconomic reforms, which have created a more dynamic and competitive environment. Substantial progress has also been made in reforming and strengthening PNG's financial infrastructure.

In 2010, the PNG economy moved into a new phase, with the commencement of the PNG LNG project, the largest private sector investment undertaken in this country. For 2011, the economy is expected to continue to grow strongly, as the construction work of the PNG LNG project ramps up. This is anticipated to bring substantial benefits to a number of industries in the economy, either through the direct provision of goods and services to the project or indirectly through increased spending in the economy.

However, while this is a welcome development, a key challenge for the Government is to ensure that price stability is maintained in the face of significant inflationary pressures that are likely to arise in the near term.

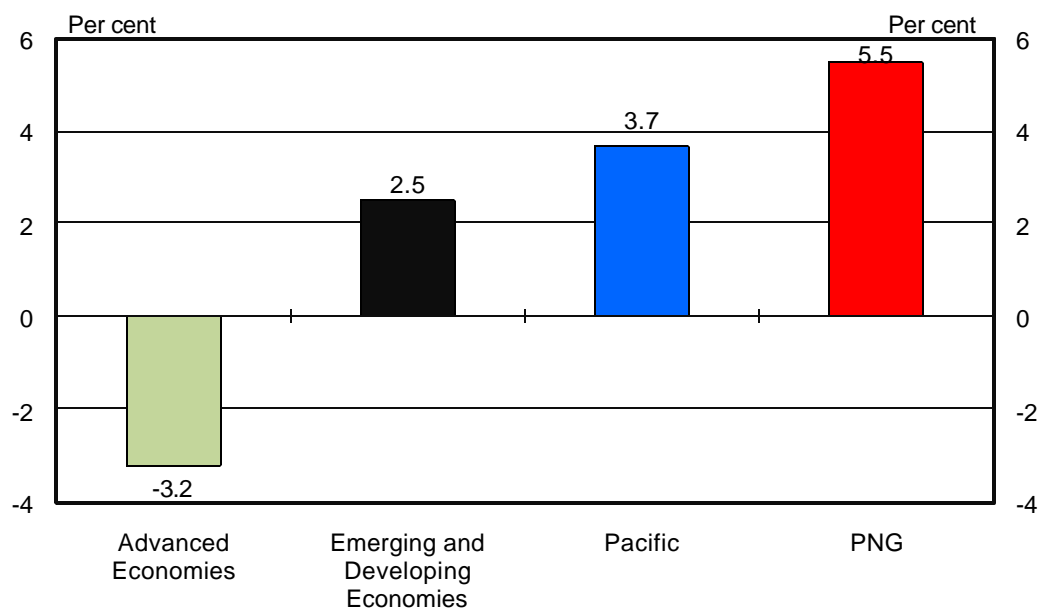
2.3 GROSS DOMESTIC PRODUCT

2009 Update

The PNG economy was able to navigate the global recession in 2009 better than expected. Business activity remained solid, buoyed by the expectation of the PNG LNG project commencing and confidence remained high following two very strong years of economic growth in 2007 and 2008. The financial sector was also resilient to the problems faced overseas, due to a strong domestic funding base, relatively low exposure to troubled international instruments and well managed balance sheets. This allowed the finance industry to continue its important role of supporting economic growth through financial intermediation to the private sector. The most heavily affected sectors were the agriculture, forestry and fisheries and manufacturing sectors, which experienced a decline in export demand and prices, due to the contraction of global demand.

The economy grew by an estimated 5.5 per cent in 2009, which was lower than growth experienced in 2008 but higher than the 4.5 per cent forecast at the time of the 2010 Budget. Total estimated non-mining GDP grew by a strong 6.3 per cent in 2009, down from 7.6 per cent in 2008. Figure 15 shows that despite the softer growth in 2009, the PNG economy performed relatively well during the global recession.

Figure 15: Comparative Economic Growth in 2009



Source: Department of Treasury for PNG growth estimate, IMF for advanced, emerging & developing economies and ADB for the Pacific estimate.

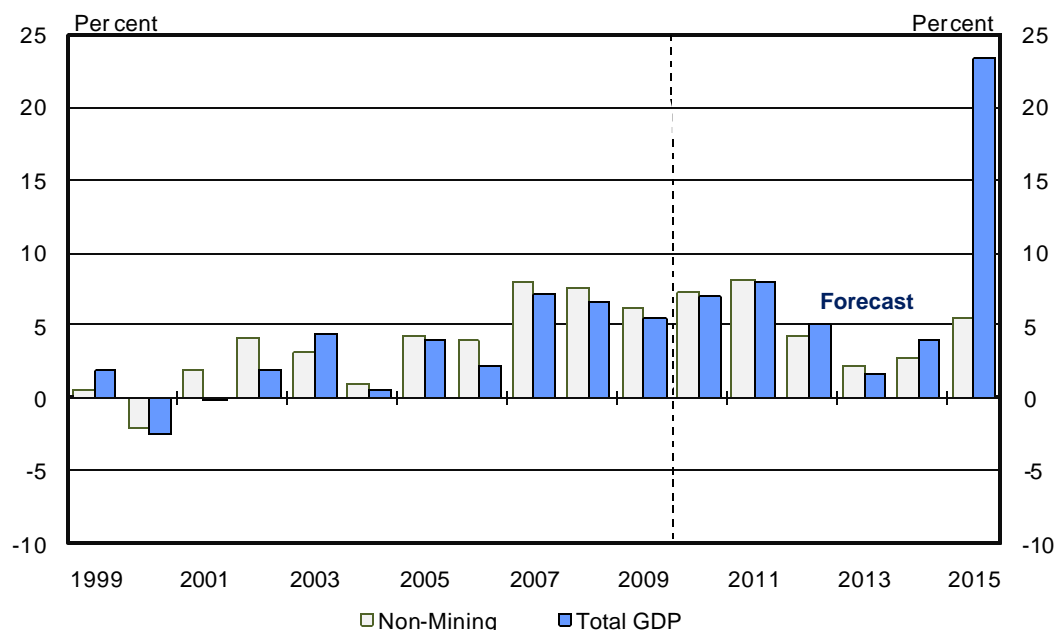
2010 Update

The PNG economy is expected to rebound and grow very strongly at 7.1 per cent in 2010. This is lower than the 8.5 per cent forecast at the time of the 2010 Budget and 7.5 per cent projected in the Mid-Year Economic and Fiscal Outlook (MYEFO). Although economic growth has been somewhat slower than anticipated in the first half of the year, economic

activity is expected to pick up in the latter half of 2010 driven by the expected ramp up in construction activity associated with the PNG LNG project. The downward revision from the previous updates is due to a number of factors.

- A number of mines have experienced a range of problems that have led to lower productions; these include Ramu Nickel, Ok Tedi and Porgera.
- Coffee and Cocoa production is expected to be lower in 2010 due to weather related issues and cocoa pod borer.
- A slight delay in the construction work of the PNG LNG project in 2010. The project has been affected to some extent by landowner issues delaying progress at different stages during the year. However, the commencement of LNG production in 2014 is not expected to be affected.

Figure 16: Economic Growth 1999 - 2015



Source: Department of Treasury

The mining and quarrying sector is expected to grow by 7.6 per cent in 2010. This is much higher than 0.1 per cent growth in 2009 due to the commencement and progression of production at some of the new mines, including Ramu Nickel and Hidden Valley. However, the forecast growth is well below the 2010 Budget projection of 23.4 per cent, reflecting the downgrade revision to first year mine production at Ramu Nickel and lower than expected copper and gold production at Ok Tedi due to the strike action taken by employees in April. In addition, lower gold production is also expected from Porgera following unfavorable weather conditions, infrastructure related issues and illegal mining activities affecting mine operations during the year.

The oil and gas extraction sector is expected to decline by 4.6 per cent in 2010. This is slightly better than the decline of 18.6 per cent forecast in the 2010 Budget. There have

been some improvements in the production process at Kutubu, Gobe and SE Mananda in 2010, which has improved extraction rates, resulting in the upward revision in 2010. Overall, the oil and gas sector continues to decline, reflecting the natural production decline in all existing oil fields.

Total non-mining GDP is expected to grow at 7.3 per cent in 2010, up from 6.3 per cent in 2009.

The agriculture, forestry, fisheries sector is expected to grow by 3.5 per cent in 2010. This follows weak growth of 0.7 per cent recorded in 2009, which saw trade disruptions due to the global recession. The rebound reflects higher production across most agricultural products, driven by stronger commodity prices on global markets. While this is a solid rebound, it is slower than the 2010 Budget projection of 4.8 per cent. The downward revision to growth since the 2010 Budget is mainly due to lower than expected coffee and cocoa production in 2010. The recent dry weather experienced in the coffee growing regions of the Highlands has affected production for the first half of the year. In addition, the negative impact of the cocoa pod borer continues to affect production in East New Britain, leading to a downgrading of total production from the main cocoa producer in the country. Offsetting these negative developments in coffee and cocoa are the stronger forecast production for palm oil and copra, as more farmers are tending to their plantations in response to higher prices in 2010.

The construction sector is expected to grow by a very strong 14.0 per cent in 2010. The expansion of private sector development has already seen the construction of a number of residential and business complexes, especially around Port Moresby and Lae. While growth is slightly lower than the 17.0 per cent experienced in 2009, activity is at high levels, reflecting very strong growth in this sector over the past few years. Growth in the sector is also being limited by capacity constraints.

The transport, storage and communication sector is expected to grow by 16.5 per cent in 2010. According to Treasury's business liaison visits, more expansion is expected in the communication segment, with the roll-out of additional mobile phone site towers in 2010. The transport and storage segment is also expected to experience strong growth, with increased demand for transport and storage services associated with the increased activity flowing on from the PNG LNG and other mining projects.

The manufacturing sector is expected to grow strongly by 6.0 per cent in 2010, rebounding from 0.2 per cent in 2009. This is attributed to improving global demand and a stronger domestic economy. Visits to businesses indicate that the vibrant domestic economy has translated into higher disposable incomes, which is having a positive impact on consumer spending for locally manufactured goods. Businesses in this sector have also noticed that consumers have become more sophisticated and are demanding a wider variety of goods. This has seen local manufacturers improving the range of products they deliver into the market, as well as a greater demand for imported goods.

The electricity, gas and water sector is expected to grow strongly at 8.7 per cent in 2010, driven by the additional activity generated by the PNG LNG project. However, according to Treasury's business liaison visits, the sector is also facing a wider range of infrastructure problems relating to power lines, dams and roads, which are affecting current services and expansion plans. The Government is mindful of these issues and is working closely with the relevant State Owned Enterprises to solve some of these issues.

Wholesale and retail trade is forecast to grow by a strong 12.0 per cent in 2010. Businesses have pointed out that the exceptional economic growth over the past few years has created more employment opportunities in the economy and higher wages. Combined with the increase in the minimum wage, this has led to an increase in household disposable incomes, providing a positive impetus to consumption spending.

Finance, real estate and business services is expected to grow by 9.5 per cent in 2010, driven by strong demand for financial services as businesses are expected to continue taking advantage of increased investment opportunities associated with the PNG LNG project and the strong domestic economy. Real estate and business services are also expected to increase in line with strong economic activity.

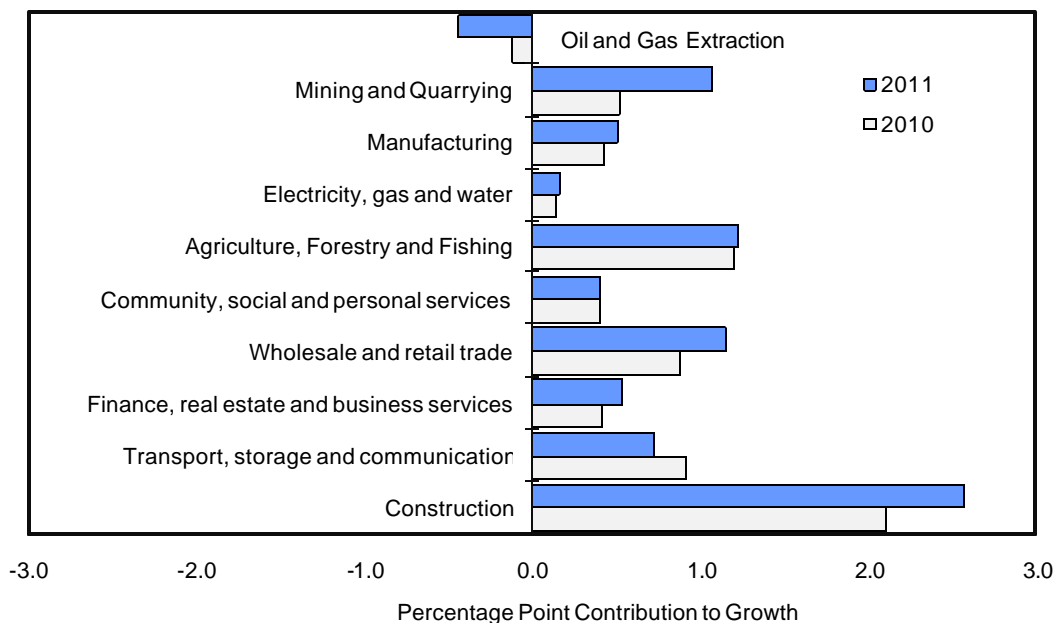
2011 Outlook

Real GDP is expected to increase by a strong 8.0 per cent in 2011, largely driven by the expected ramp up in PNG LNG construction, which will have a direct impact on the construction and transport sectors. The additional activity created by the PNG LNG project is also expected to provide a significant boost to activity in other parts of the economy, with rising incomes and consumption from businesses and households. Conditions in the global economy are expected to remain supportive of the export-orientated industries.

Economic growth in 2011 has been revised up from the 2010 Budget forecast; this largely reflects the expected delays in the construction phase of the PNG LNG project in 2010 being pushed into 2011 and the resumption of normal production activity in a number of major mines that experienced some difficulties in 2010.

The mining and quarrying sector is expected to grow by a very strong 15.6 per cent in 2011, largely due to the ramp up of production at the Ramu Nickel mine. This is supported by higher production at Ok Tedi and Porgera, which are expected to return to normal operations following disruptions in 2010. Smaller new mines like Simberi and Hidden Valley are also expected to contribute to growth as they improve capacity in 2011. The petroleum sector is expected to decline by 19.5 per cent in 2011, due to lower extraction rates from maturing oil fields.

Non-mining GDP is expected to grow by 8.2 per cent in 2011, largely driven by stronger growth in the construction and wholesale and retail trade sectors. All non-mining industries are expected to expand in 2011.

Figure 17: Contribution to growth by sectors, 2010 and 2011

Source: Department of Treasury

The agriculture, forestry, fish eries sector is expected to grow by 3.7 per cent in 2011. This is higher than in 2010 and reflects an expected rebound in coffee production after the weather related disruptions in 2010. Despite this, the coffee bi-annual season remains unpredictable and poses some risks to production if a negative season unfolds. Other cash crops like cocoa, copra and palm oil are also forecast to expand, driven by high prices and improved growing conditions.

The construction sector is expected to grow by a very strong 16.0 per cent in 2011, driven by construction activity created by the PNG LNG project, higher Government investment and strong private sector investment that has risen as a result of the rapid expansion in the domestic economy. The slight acceleration to growth from 2010 reflects the deferral of some construction projects in 2010 into 2011, in particular some of the PNG LNG construction. However, Treasury's business liaison visits indicate that capacity is tightening in the economy, particularly in the construction sector. The availability of scarce resources is also likely to constraint the growth of domestic construction activity. Increasingly, additional construction projects will need to be undertaken by foreign firms, which will have a smaller value add to production in PNG.

The transport, storage and communication sector is expected to grow by 12.0 per cent in 2011. Activity in this sector will be driven by the continuing expansion in the mobile phone industry, as service providers make additional investment to improve coverage and attract more users. This includes the roll-out of additional site towers and introduction of a wider range of products into the market. The transport and storage sector is also expected to grow strongly to meet the demands of the PNG LNG project and the increased business activity in the domestic economy. Overall, growth is slightly lower than in 2010, reflecting some maturation in the communication sector, which has experienced tremendous growth over the past few years.

For the rest of the economy, the ramp up in the PNG LNG project is expected to provide a boost to activity, as increased profitability, higher employment and strong wages and salary growth flows through to a number of sectors that do not have direct links to the project. Strong double digit growth is expected for wholesale and retail trade, finance, real estate and business services and electricity, gas and water.

Medium Term Outlook

Economic growth is expected to ease over the medium term, especially in 2013 when the PNG LNG construction phase winds down. In addition, the declining production from the maturing oil fields and the slowdown of activity at Ok Tedi as it moves to closure in 2014 (pending expansion plans) will have a negative impact on growth. Strong performing sectors such as construction and communication are also likely to grow more slowly than in previous years. Nevertheless, the medium-term forecasts do not yet incorporate the prospect of a second LNG project coming on stream, which provides upside risk to the forecasts presented. In 2014 and 2015, PNG LNG production is expected to come on line, providing a very large boost to GDP growth.

Agriculture, Forestry, Fisheries

Over the medium term, the agriculture sector is expected to expand, especially in the palm oil industry, which is expecting improved capacity through new mills and replanting programs. While copra production is also expected to grow, it is highly sensitive to prices and is likely to contribute to growth as long as prices remain high in the medium term. Coffee production depends on the weather conditions and the bi-annual season. The cocoa industry is expected to continue its implementation of improved farming techniques and to carry out awareness in relation to the cocoa pod borer as the industry continues its efforts to educate farmers about better ways to sustain production.

The forestry sector is expected to decline, as most key logging licenses expire and as most logging species become scarce. The sustainability of logging is a concern and the Government needs to consider ways of reforestation to improve the sustainability of the industry. The fisheries sector is expected to maintain solid growth over the medium term, driven by downstream activities and improved community related programs aimed at improving small business. The National Fisheries Authority is also expected to undertake a program in the medium term aimed at providing fish farmers with credit facilities in an attempt to support local businesses in the industry.

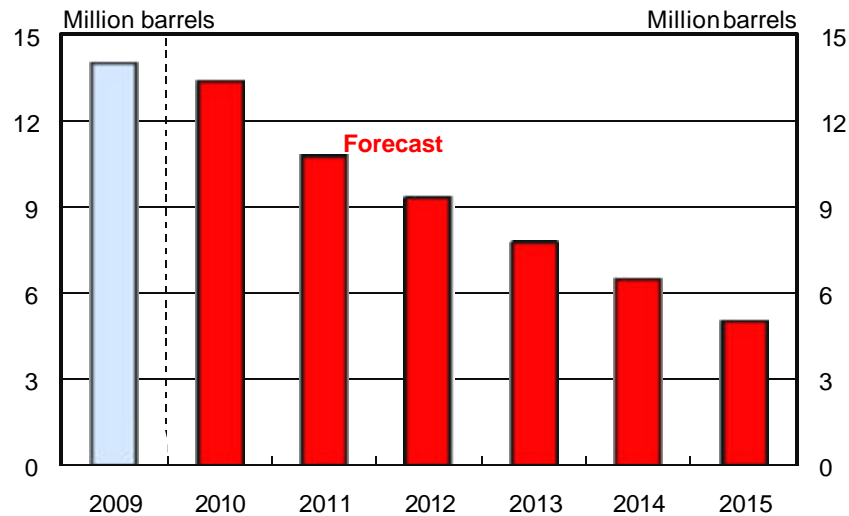
Mining and Petroleum

The Mining and Quarrying sector is expected to grow very strongly in 2011 and 2012 as recent and new mines realise full production. However, in 2013, production is expected to decline as mature mines like Ok Tedi wind down operations and prepare for closure in 2014. Ramu Nickel is expected to commence production in the latter stages of 2010, ramping up to full production in 2012, with production expected to remain steady thereafter.

The declining trend of oil extraction is expected to continue to weigh down on the Petroleum sector, with production rates expected to decline from around 13 million barrels expected in 2010 to 5 million barrels in 2015. This continues to reflect the rundown of reserves from existing fields. Marginal fields like South East Mananda and Gobe are likely to end earlier than previously expected. While production of oil may be declining at an increasing pace, the

PNG LNG project which is anticipated to commence production of LNG in 2014 and provide a significant boost to production in the petroleum and gas sector.

Figure 18: Declining oil production over the medium term



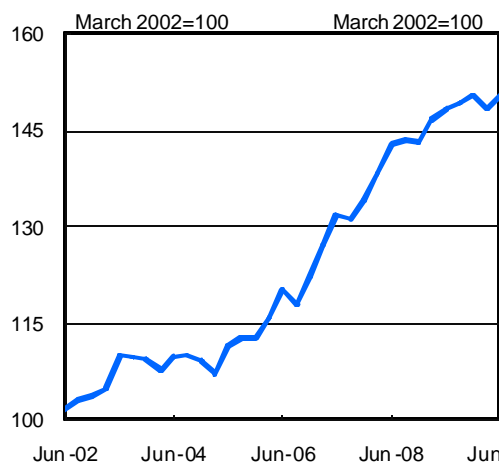
Source: Department of Treasury and Department of Petroleum & Energy

2.4 LABOUR MARKET

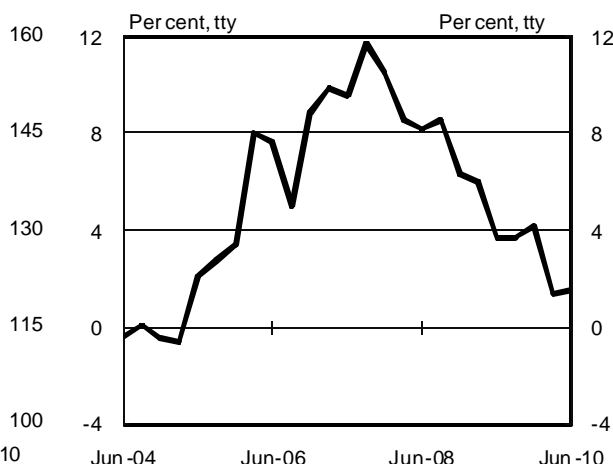
PNG has experienced strong private sector employment growth since June 2005, although the rate of growth has eased over the past two years. This sustained employment growth has been largely driven by a period of uninterrupted economic growth.

More recently, employment growth has eased back to low single digit rates, which to some extent is due to the softer economic conditions in 2009. In addition, the Bank of PNG (BPNG) employment survey is likely to be understating employment growth, as the survey does not capture all employment from the PNG LNG contractors.

The BPNG employment index showed that employment in the formal private sector increased by 1.3 per cent in the June quarter 2010 (compared to a 1.1 per cent decline in March) to be 1.6 per cent higher through the year.

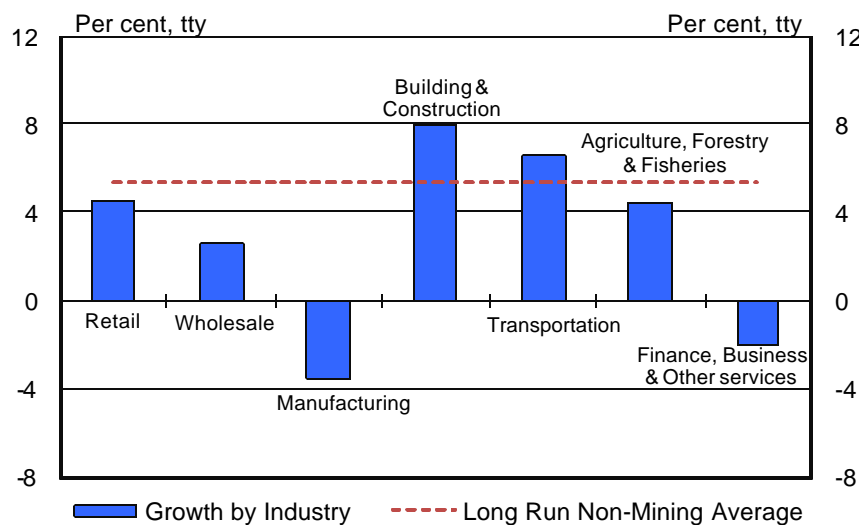
Figure 19: Employment Index

Source: Bank of PNG and Department of Treasury

Figure 20: Total Employment growth

Source: Bank of PNG and Department of Treasury

In the June quarter 2010, employment increased in most sectors of the economy except in the manufacturing and finance, business and other services sectors. Compared to employment levels a year ago, the strongest increases were observed in the Building and Construction and Transport sector, which were 8.0 per cent and 6.6 per cent higher respectively, followed by the mineral, retail and agriculture sector. The increase reflected higher activity associated with the construction phase of the PNG LNG project and other mining projects, and the harvesting of coffee and palm oil.

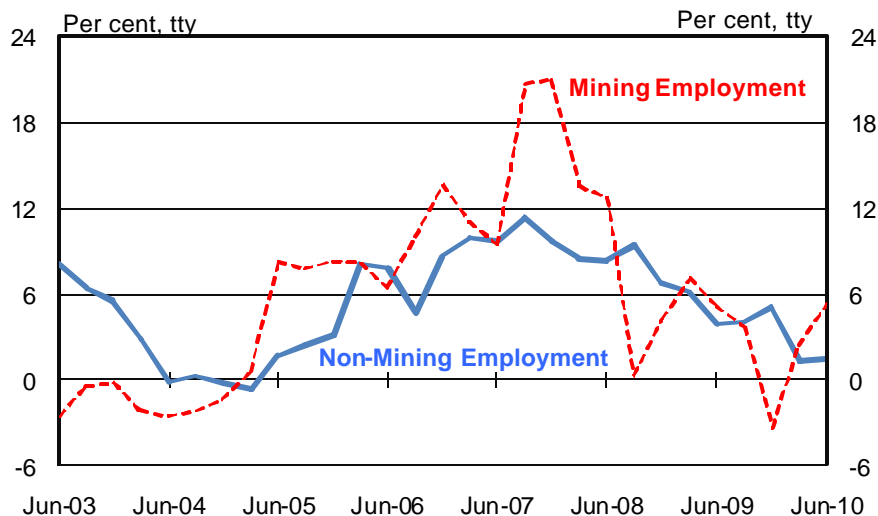
Figure 21: Industry Employment growth - Year to June quarter 2010

Source: Bank of PNG and Department of Treasury

In the mineral sector, employment is beginning to pick up again, buoyed by stronger commodity prices and growing global demand. Mineral employment grew by 3.0 per cent in the June quarter 2010, to be 5.2 per cent higher through the year, with the rise in employment reflecting activities associated with new mining projects coming on stream.

Excluding the mineral sector, employment increased by 1.3 per cent in the June quarter 2010, to be 1.3 per cent higher through the year.

Figure 22: Mining and Non-Mining employment



Source: BPNG and Department of Treasury

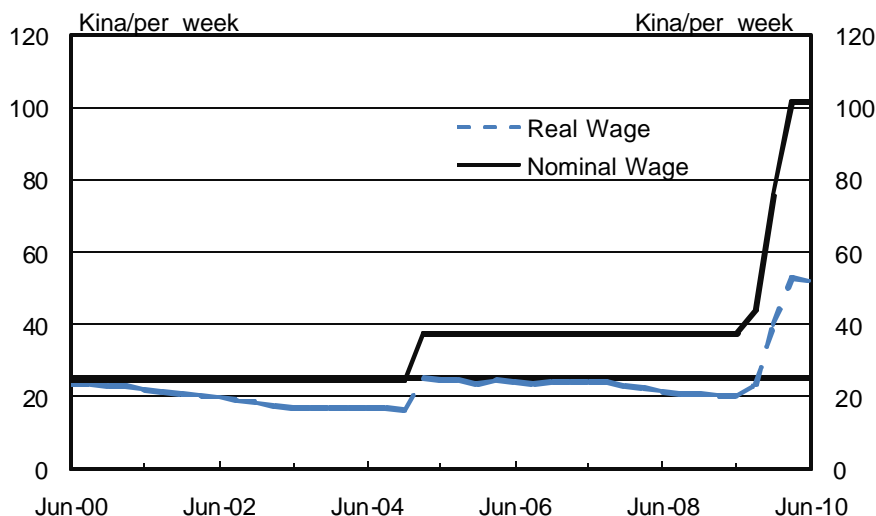
With the global economic recovery on a more solid footing and with the PNG LNG construction ramping up in late 2010 and into 2011, it is expected that employment growth will begin to pick up again. However, the difficulties of businesses finding skilled labour remains a constraint on employment growth. This can only be addressed through the improvement in training and the investment in human capital. The Government is addressing this concern through the Medium-Term Development Plan. However, human capital improvement is a long-term process where benefits will not be realized in the short term.

Wages Growth

Nominal salary and wages in the economy has increased over recent years, in line with strong employment growth and wage increases in PNG. It is expected that wages growth will remain strong, particularly for skilled labour and in the faster growing sectors of the economy. As the economy continues to expand, businesses are finding it increasingly difficult to find skilled labour from the existing labour pool. As a result, employers have resorted to a number of measures to bridge supply constraints, including greater focus on training and development, importing labour abroad and paying higher wages including bonuses and incentives to retain and compete for skilled employees.

Anecdotes from businesses combined with strong increases in personal income tax revenue suggests that wages growth has been very strong, particularly over the last year.

For non-skilled labour, there have been substantial wage increases in the past year as the two stage increase to the minimum wage as determined by the Minimum Wage Board (MWB) has come into effect.

Figure 23: Minimum Wages

Source: Bank of PNG, National Statistics Office and Treasury

The MWB approved the new minimum wage increase from the previous rate of K37.20 per week. Upon approval, the new wage rates were implemented in two phases. The first phase was an adjustment in the minimum wage to K1.72 per hour or K75.68 per week (based on a 44-hour week) to be implemented 26 weeks after the effective date of the MWB Determination. The second adjustment was to take the full determined hourly rate to K2.29 per hour or K101.76 a week, to be implemented 40 weeks after the effective date of the MWB Determination.

2.5 PRICES

Inflation remains persistent in PNG as domestic resources are stretched by the rapid expansion that the economy has undergone in the past few years. The strains on capacity are showing, with businesses finding it increasingly difficult to find suitable labour and land for further expansion. This is translating into strong wages growth and rapidly increasing prices associated with the use and development of land. In the near term, these inflationary pressures are expected to increase, with the ramp up in the construction of the PNG LNG project and the significant increase in Government expenditure.

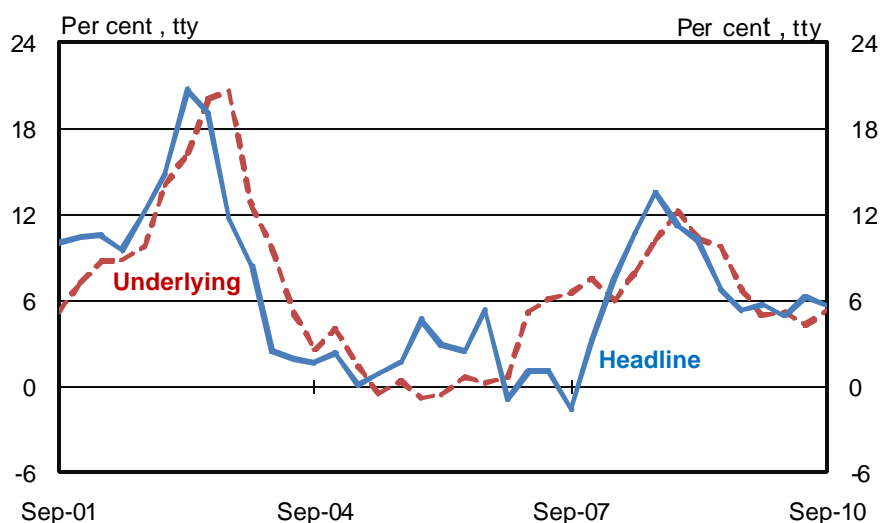
One of the key challenges for a developing economy like PNG is to manage the resource boom well so that rapid economic expansion does not translate into continuously high inflation. Inflation represents a real problem, for ordinary households and businesses. For households, higher inflation translates into rising cost of living, as the price of general goods and services increases; this ultimately leads to lower household wellbeing. For businesses, higher inflation translates into a higher cost of doing business, due to rising input costs. In the business environment, uncertain price movements can also lead to uncertainty in relation to actual business investment and therefore can act as a drag on long-term economic growth. The Government needs to carefully balance the inflationary pressures that are building in the economy to address development needs of the country.

2010 Update

In the September quarter 2010, the headline consumer price index (CPI) increased by 1.3 per cent, to be 5.6 per cent higher through the year. The most significant price increases were recorded in fruit and vegetables, clothing and footwear, council charges, alcoholic drinks and motor vehicle purchases. Surprisingly, compared to the previous quarter, measured inflation eased with the most significant price moderations found in a number of food items, such as fruit and vegetables, cereals and meat and fish.

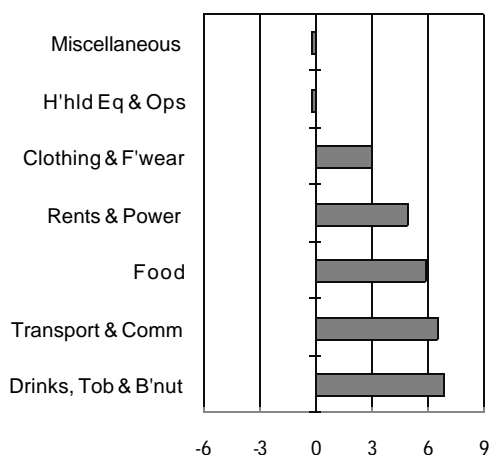
The exclusion-based measure of annual underlying inflation increased slightly, with prices rising by 5.4 per cent in the September quarter 2010, up from 5.3 per cent in the previous quarter. The Central Bank's trimmed mean measure also indicated that annual underlying inflation was 5.7 per cent in the September quarter, slightly down from 5.8 per cent in the June quarter.

Figure 24: Consumer Price Index, through-the-year growth



Source: NSO and the Department of Treasury

All regions recorded price increases in the September quarter, with the strongest increases experienced in Lae and Goroka which recorded quarterly price increases of 2.2 per cent and 1.4 per cent respectively. Compared to September quarter 2009, the largest consumer price increases were experienced in Madang and Goroka, which recorded through-the-year inflation of 8.3 per cent and 7.7 per cent respectively.

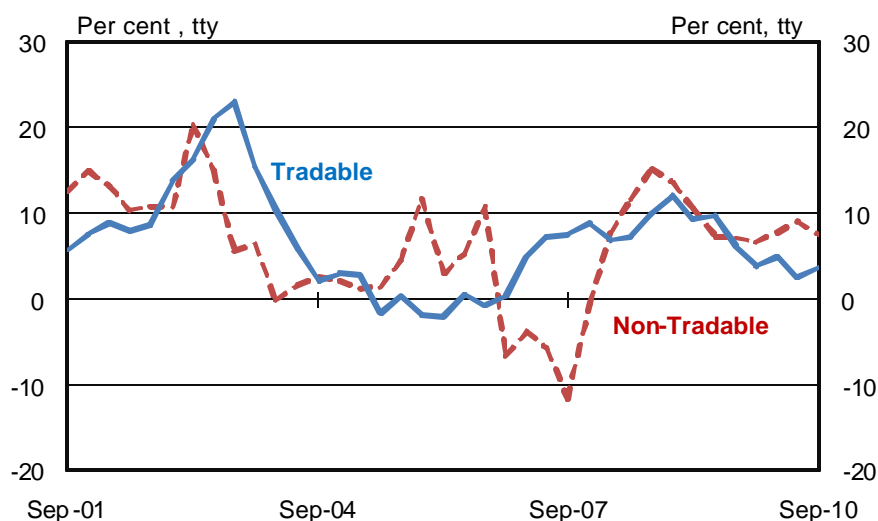
Figure 25: Through-the-year CPI by group**Figure 26: Through-the-year CPI by Region**

	Quarterly	Through the year
Port Moresby	1.0	4.9
Goroka	1.4	7.7
Lae	2.2	5.5
Madang	0.7	8.3
Rabaul	0.6	4.0
Total	1.3	5.6

Source: NSO and the Department of Treasury

Tradable and Non-Tradable Inflation

Prices of imported (or tradeable) goods have edged up slightly, increasing by 3.8 per cent through the year to the September quarter 2010 compared to 3.7 per cent through the year to the June quarter. The downward trend in tradable inflation since 2008 has helped to contain overall inflation, but this could reverse if the world economic recovery leads to stronger international prices.

Figure 27: Tradable and Non-Tradable Inflation, 2001-2010

Source: NSO, and the Department of Treasury

Figure 27 shows that annual non-tradable (i.e. domestically generated) inflation has been rising for a number of quarters, although it moderated slightly in the September quarter 2010. Non-tradable inflation prices continued to grow strongly, rising by 1.5 per cent in the September quarter 2010, to be 7.6 per cent higher through the year. Non-tradable inflation is expected to remain strong and rise in the near term due to capacity constraints in the economy. This is not unexpected given the economy has grown strongly for a number of years, which has absorbed available resources. The significant increase in aggregate demand has outstripped expansion in the capacity of the economy, which is now manifesting into higher prices for the different factors of production.

Fortunately, businesses in PNG have been able to alleviate some of these constraints, such as skilled labour and capital, by drawing on resources from abroad. This has been made easier with a number of countries still operating at below full capacity following the global recession in 2009. As the world economic recovery gathers momentum, PNG will face increasing competition for these external resources, which is expected to lead to higher input costs.

Although the recent trend in the measured inflation figures point to some moderation in inflationary pressures, annual inflation remains significantly above those levels recorded in the years prior to 2008. While the strong international cost pressures experienced in 2008 were picked up in the official statistics, primarily through higher food and fuel prices, there is a concern that current domestic inflationary pressures are being understated in the official statistics produced by the National Statistical Office (NSO). Anecdotal evidence from business liaison visits, suggest that inflation could have been as high as double digits in the past year, with a number of businesses factoring these figures into their negotiations rather than using official price statistics.

For example, there are a number of domestic expenditure items such as the price of dwelling rentals which are reported to have been unchanged in NSO figures for the past two decades. This is despite the enormous increase in dwelling rents that have been observed over the past few years, which highlights inadequacies in the official statistics. Furthermore, the weightings in the expenditure basket were taken in the 1970s. These outdated weights do not properly reflect the increasing importance of expenditure on items such as fuel and housing. Once a new household expenditure survey is compiled by the NSO, the survey data will provide a timely update to the weightings used in the consumer price index expenditure basket.

Inflation Outlook

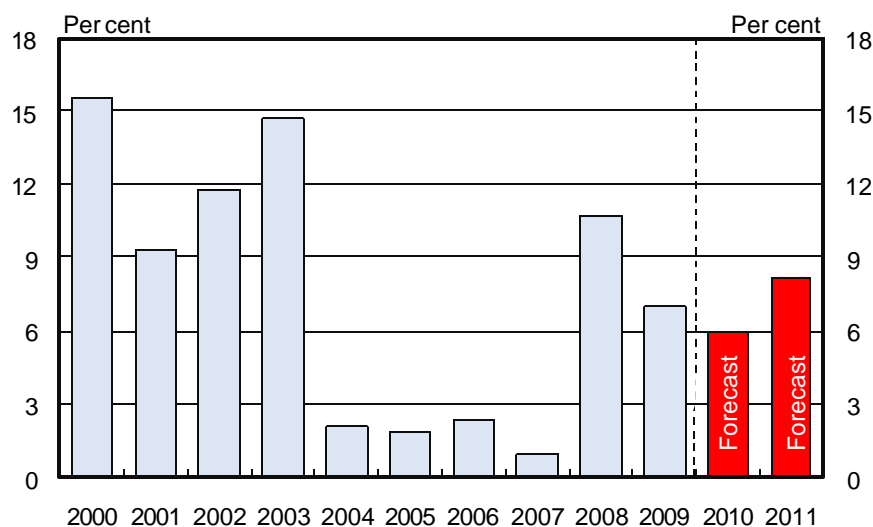
Inflation increased significantly in 2008 and has remained at relatively high levels compared to the low inflation period of 2004 and 2007. Looking ahead, inflation is anticipated to increase, posing a risk to macroeconomic stability.

Treasury has revised its annual headline inflation projection for 2010 to be around 6.0 per cent, a slight downward revision from the MYEFO estimate of 7.0 per cent. The downward revision to the 2010 projection from previous updates is based on the following factors:

- A lower inflation outcome recorded in the first nine months of 2010, which has been driven by a moderation in price growth of key expenditure groups such as; food, drinks, tobacco and betel nut.

- The slight downward revision to real GDP growth in 2010, including some delay in the construction phase of the PNG LNG project has eased inflationary pressures.
- In 2009, there was a significant increase in the amount of funds coming out of Government trust funds. This was expected to add to aggregate demand through increased spending in the economy. However, some of those funds are yet to be spent on domestic goods and services. It is expected that when those funds are spent they are likely to add to inflationary pressures.

Figure 28: Actual and Projected inflation; 2010-2011



Source: NSO, Bank of PNG and Department of Treasury

In 2011, headline inflation is projected to rise to 8.2 per cent, revised up from 8.0 per cent projected in the Mid-year Economic and Fiscal Outlook (MYEFO). The higher inflation outlook takes into account the following factors.

- Aggregate demand is anticipated to be stronger in 2011, which will see increased investment and spending activity, this is likely to add to rising inflationary pressures.
- PNG LNG construction activity is expected to ramp up in 2011, which will put pressure on existing resources in the economy.
- Shortage of skilled labour and other capacity constraints has been a problem for a while and is expected to become tighter. This has led to strong wage increases for skilled labour, as business compete for skilled workers. The other chronic problem is the shortage of land, which has caused higher rental prices for offices and accommodation. The pressure on these scarce resources is expected to intensify in 2011.

- Government spending has increased substantially in recent years. Given the capacity constraints in the economy, the additional aggregate demand created by public spending is expected to translate into higher prices.
- The depreciation of the Kina against the Australian dollar implies that prices of basic goods and services imported from Australia will rise. This also means that both the domestic and imported inflation are likely to trend upwards, as businesses pass on higher prices to consumers.

Over the medium term, inflation is assumed to gradually moderate to around 5.0 per cent per annum, which represents the long-term average inflation rate in PNG. This assumption is based on the effective implementation of monetary policy in anchoring inflation expectations. However, should monetary policy respond too slowly or fiscal policy becomes too expansionary, there is a risk that inflation will be higher than the medium-term assumption.

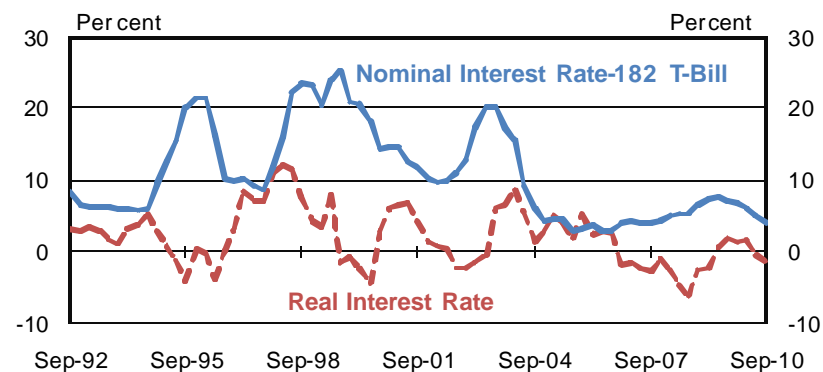
The key challenge for the Government is to contain inflation so that it does not accelerate rapidly. Inflationary pressures are currently high in the domestic economy and are anticipated to accelerate further as the economy absorbs the significant impact of the PNG LNG project.

Over the near term there is a potential for the economy to grow more strongly than anticipated should other new mining ventures and the second LNG project eventuate. This means that risks to the inflation forecasts remain elevated.

2.6 MONETARY DEVELOPMENTS

Key interest rates such as the Kina facility rate (KFR) which is used by Bank of PNG (BPNG) to signal its monetary policy stance has been maintained at 7.0 per cent since December 2009. BPNG stated that this KFR setting was to prevent increases in inflation driven by high domestic demand associated with Government spending and the commencement of the construction phase of the PNG LNG project. There was also a growing concern of inflationary pressures emanating from imported inflation, with the Kina depreciating against its major trading partners (especially against the Australian dollar) and the excess liquidity within the economy. Nevertheless, Figure 29 indicates that real interest rates are at very low levels, which represents a risk to consumer and asset price inflation when the economy is growing strongly.

The repo interest rate has remained unchanged since December 2009. However, domestic interest rates for short-term securities and deposits have continued to decline over the course of 2010. The lower deposit rates were attributed to excess liquidity in the banking system, which is due to high foreign exchange inflows and increased government spending.

Figure 29: Nominal and Real Interest Rates

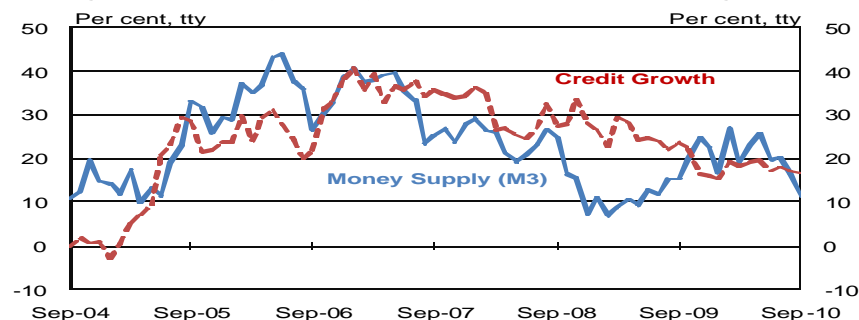
Source: Bank of PNG

The annual growth of broad money supply (M3*) was 11.4 per cent over the year to September 2010. The growth in the money supply was mainly due to higher net foreign assets of depository corporations and private sector credit growth extended by other depository corporations. The growth in the monetary base was mainly attributed to the drawdown of funds by the Government kept in trust accounts which impact the level of currency in circulation and deposits of commercial banks. Liquidity remains at high levels which exerted downward pressure on domestic interest rates. To help diffuse such a high level of liquidity in the banking system, the Central Bank issued new net Central Bank Bills (CBBs) totalling K773.3 million over the nine months to September 2010 and increased the cash reserve requirements from 3 per cent to 4 per cent of total deposits in October.

In 2010, BPNG projects broad money supply to grow by 20.6 per cent, resulting from higher growth in credit by the private sector while the monetary base is expected to grow by 14.9 per cent. In 2011, both the money supply and monetary base growth should moderate slightly to 19.8 per cent and 13.0 per cent respectively.

In the year to September 2010, total private sector credit increased by 16.6 per cent compared to 23.6 per cent in the corresponding period of 2009. High levels of credit growth poses a threat to inflation via additional spending in the economy, which can lead to higher asset and consumer prices.

In 2010, BPNG projects private sector credit to grow by 16.0 per cent, rising to 17.0 per cent in 2011.

Figure 30: Money supply and Private Sector credit growth

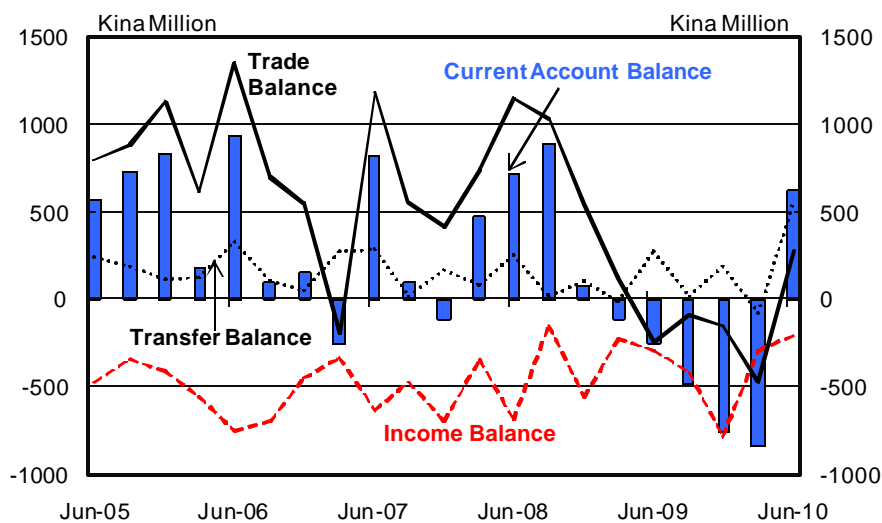
Source: Bank of PNG

2.7 BALANCE OF PAYMENTS AND INTERNATIONAL PRICES

Balance of payment data show that PNG's trade activity with the rest of the world continued to improve over the course of 2010, reflecting improvements in the external environment and stronger domestic economic activity. This has seen a significant pick up in the export and import of goods and services. The value of exports was 46.4 per cent higher in the June quarter 2010 compared to the corresponding quarter in 2009. Similarly, export volumes rose by 8.1 per cent, while the value of imports was 19.6 per cent higher.

A current account surplus of K692 million was recorded by the Bank of PNG (BPNG) in the June quarter 2010 - the first surplus since December quarter 2008. This was largely driven by the trade balance moving from a deficit to a surplus position in the June quarter, due to a combination of stronger export volumes and prices. Supporting this was an improvement in the transfer balance and a narrowing of the net income deficit. Over the first six months of 2010, the current account balance recorded a deficit of K216 million or 0.8 per cent of GDP, with the June quarter surplus partially offsetting the March quarter deficit of K908 million.

Figure 31 : Drivers of the Current Account Balance 2005-2010



Department of Treasury and Bank of PNG

A current account deficit of K6,863 million or 26.6 per cent of GDP is forecast for 2010, which is substantially larger than the annualised current account deficit recorded by the BPNG over the first six months of the year.¹ This large discrepancy is due to problems associated with measuring the impact arising from the PNG LNG project. Treasury understands that BPNG's published figures currently understate transactions relating to the PNG LNG project, as a number of key contractors are not captured in the BPNG survey. As a result, these differences are likely to persist until this measurement issue is resolved.

¹ In BPNG's September Monetary Policy Statement, a current account deficit of K11.9billion is forecast in 2010. The significant difference between the forecast is likely to relate to the assumed profile and impact of the PNG LNG project on the current account balance.

The revised deficit in 2010 is slightly below the 2010 Budget forecast deficit of K6,924 million or 26.8 per cent of GDP, largely reflecting some delays in the PNG LNG project and an upward revision to exports in line with stronger commodity prices and volumes in the first six months of the year. Partially offsetting this is a larger than anticipated increase in imports of goods and services relating to mining projects.

While the projected current account deficit is broadly in line with the 2010 Budget forecast, the composition of the deficit has changed. In particular, the net income deficit has been significantly revised up, as the compensation of employees abroad was previously incorrectly recorded under the imports of goods and services.

According to BPNG, a trade surplus of K460.0 million was recorded in the June quarter 2010 compared to a deficit of K662 million in the March quarter. This was the first time the trade account has been in surplus since the global recession in 2009, owing to higher export prices and volumes and lower merchandise imports. In particular, service imports were 25 per cent lower in the June quarter compared to the March quarter, especially in other financial services, construction services and transportation. Over the first six months of 2010, the trade balance recorded a deficit of K202 million or 0.8 per cent of GDP.

The trade deficit is expected to widen to K2,917 million (11.3 per cent of GDP) in 2010. This is largely due to higher imports of goods and services as the PNG LNG project increases construction activity in the second half of the year and as general imports rise with the strengthening of domestic economic activity.

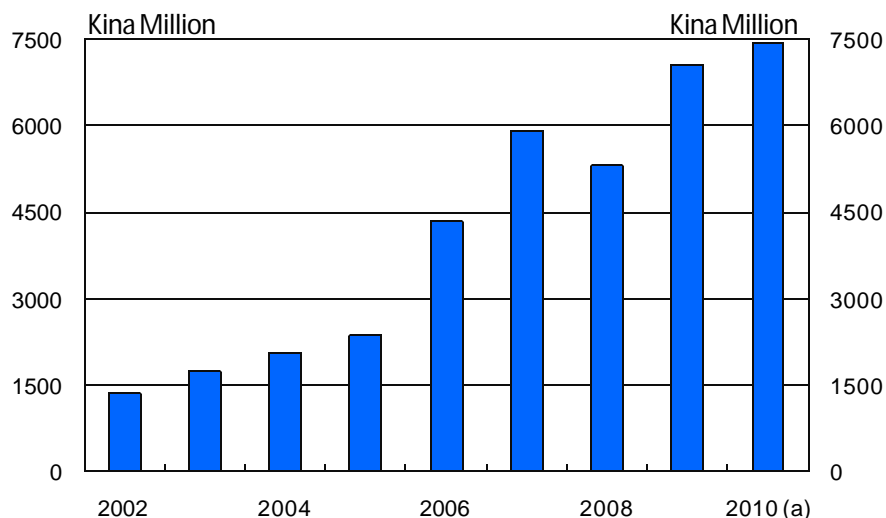
According to BPNG, a net income deficit of K184 million was recorded in the June quarter 2010 compared to a deficit of K314 million recorded in the previous quarter. The narrowing of the net income deficit was attributed to lower compensation of employees, interest and income payments during the quarter. Over the first six months of 2010, the net income deficit was K498 million or 1.9 per cent of GDP.

The net income deficit is expected to widen to K4,299.4 million (16.6 per cent of GDP) in 2010. This is largely due to higher compensation of employees relating to the PNG LNG project and higher dividends payments associated with increased mining profitability from strong commodity prices in 2010.

A transfer surplus of K416 million was recorded in the June quarter 2010 compared to a smaller surplus of K68 million in the March quarter. The higher surplus was attributed to higher receipts from gifts and grants combined with slightly lower family maintenance transfer payments. Over the first six months of 2010, the transfer balance recorded a surplus of K484 million or 1.9 per cent of GDP.

The surplus in the net transfer balance is expected to fall to K339 million in 2010 (1.3 per cent of GDP). This is slightly lower than the first six months of 2010 and reflects an anticipated increase in the transfer of family maintenance payments in line with stronger economic growth in PNG.

The gold and foreign exchange reserves held by Bank of PNG at the end of September 2010 were K7,432.9 million (US\$2.8 billion). This is equivalent to 5.5 months of total imports and 15.7 months of non-mineral imports.

Figure 32: International Reserves (Kina Million)

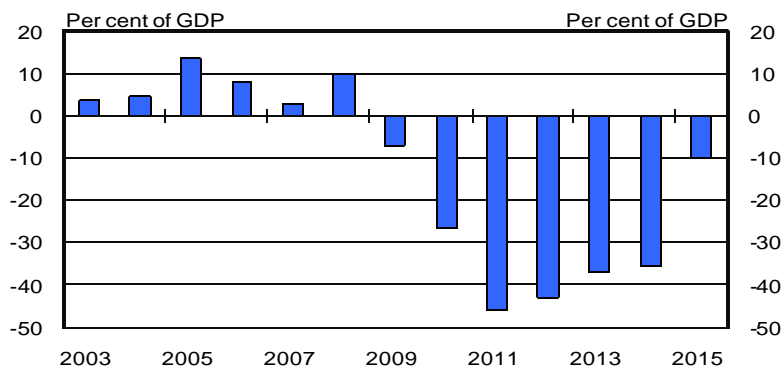
Source: Bank of PNG

(a) Includes reserves level to end September 2010

2011 Outlook

In 2011, a large current account deficit estimated at K13,192 million or 46 per cent of GDP is expected. The substantial increase in the current account deficit is largely driven by the widening in the trade and income deficit, as spending on the PNG LNG project increases in 2011. The extent of the shock to the economy associated with the construction of the PNG LNG project makes these estimates more subject to error than is usual. Stronger economic growth and incomes are also expected to result in higher general import spending.

Partially offsetting the substantial rise in the value of imports is an expected increase in agricultural and mineral exports. This reflects the expansion in production across the agriculture sector due to favourable conditions expected in 2011 and the increased rate of production at new mines like Ramu Nickel and Hidden Valley.

Figure 33: Projected Current Account Balance

Source: Department of Treasury and Bank of PNG

Medium-Term Outlook

Over the medium term the trade deficit is expected to narrow, largely driven by the significant moderation in the value of imports as the construction phase of the PNG LNG project winds down. Partially offsetting this will be the lower value of mineral exports, with commodity prices assumed to return to long-run prices by the end of the projection period, export volumes declining due to maturing oil fields and lower extraction expected from Ok Tedi as it prepares to shutdown (pending approval of proposed extensions) in 2013. By 2015, the trade balance is expected to transition from a deficit to a surplus of 2.0 per cent of GDP, boosted by the anticipated increase in mineral exports arising from LNG production.

The income deficit is expected to narrow over the medium term. This is due to lower dividend payments as mining profits decline with assumed falling commodity prices and lower compensation of employee payments as the LNG project winds down. Although from 2015 onwards with the increase in LNG exports, income payments relating to dividends and interest repayments are expected to increase significantly. The income deficit is projected to be around 12.3 per cent of GDP in 2015.

Overall, the current account balance is projected to remain in a large deficit over the medium term, driven by the import of capital and labour for the PNG LNG project and lower mineral commodity exports due to the assumption of a return to long-term prices and lower volumes. However, the deficit is projected to moderate in line with the winding down of construction spending on the PNG LNG project. As the LNG gas project begins to ramp up production, exports are expected to significantly increase leading to an improvement in the current account. It is anticipated that beyond 2015, the current account balance will move into a larger surplus position in line with LNG exports.

2.8 RISKS TO THE ECONOMIC AND FISCAL OUTLOOK

On balance, the risks to the economic and fiscal outlook are tilted to the downside.

As a small open economy, PNG is vulnerable to shocks in the global economy. While the global recession of 2009 did not severely impact PNG, it still had a negative effect on PNG's export industries and government revenue, through lower export volumes and significant falls to key commodity prices. Fortunately, the impact on PNG's export sector was relatively short lived, as the world economy strengthened over the course of 2009. As discussed in the international outlook section, the global economic recovery has been fragile with an unusual degree of uncertainty. This means that developments in the world economy remain a significant risk to PNG's economic outlook.

The uncertainty in the global economy has also resulted in volatile commodity prices, which present a key risk to the revenue forecasts. This is particularly so, with commodity prices trading well above long-term averages and at or near record levels in some instances. Should there be a negative shock to the global economy, it is likely that commodity prices will pull back significantly. In addition, if the Kina appreciates against the US dollar, this will translate into lower mineral and petroleum tax revenues when measured in Kina terms.

In the past, sharp commodity price movements had a substantial impact on total Government revenue in PNG. The vulnerability of PNG Government revenue to commodity price movements remains substantial but it has diminished over recent years due to sustained robust economic growth deepening the non-mineral tax base. This broadening of the revenue base is a welcome development in reducing the risks that PNG faces from

sharp swings in commodity prices. However, this trend will reverse once taxation revenue starts to flow from LNG production.

On the domestic front, the economy is about to experience a large adjustment with the PNG LNG construction ramping up in 2011. Given the enormity of this project, the consequences could prove hard to predict, especially in relation to the impact on inflation. There are already worrying signs of inflationary pressures building up, especially wage pressures, fuelled by increased aggregate demand associated with the rise in investment and other spending. The economy's limited resources, especially the shortage of skilled labor and land has caused higher wage and rental prices for offices and accommodation. The pressure on these scarce resources is expected to intensify and inflation is expected to increase further as the economy absorbs the substantial impact of the PNG LNG project. Therefore, the risk to inflation is heavily skewed to the upside, especially if a price-wage spiral develops as workers try to keep pace with the expected rising cost of living.

As well as the risk to consumer price inflation, another significant development has been the rapid increase in asset prices, particularly in residential and commercial property. In both segments of the property market, there has been tremendous growth in capital gains and rental income, driven by the pace of economic expansion, shortage of land and the access to relatively cheap credit. While the severe shortage of land limits the market's response to high asset prices, there is a risk that residential and commercial property may be overvalued. With the winding down of construction of the PNG LNG project anticipated in 2013, there is the risk of a correction in asset prices unless another large project fills the void.

The economic outlook assumes that fiscal discipline is maintained. The Government is strongly committed to meeting its Medium Term Development Strategy Plan (MTDSP) 2010-2015. However, with the impact of the PNG LNG project exerting intense pressure on the economy, many parts of the economy are already working at full capacity. Under these circumstances, great care will be required with additional Government spending not to exacerbate excess demand, in order to ensure that macroeconomic stability is maintained. The loss of fiscal discipline would have negative impacts on the domestic economy and investor confidence.

Other domestic economic risks include possible delays to the construction of the PNG LNG project, especially in relation to landowner issues, and supply disruptions to other mining projects due to strikes, landowner problems and weather related risks such as droughts, floods and landslides.

On the upside, a stronger than anticipated global economic outlook, would be beneficial to PNG's export sector, and could see commodity prices being higher than assumed in this Budget. In addition, there are a number of mining and gas projects which are currently under active consideration (for example the second LNG project proposed by InterOil). Should these projects proceed, this would provide a significant boost to economic growth in the near term, and a more positive revenue outlook over the longer term.

CHAPTER 3. 2011 BUDGET: REVENUE AND GRANTS

3.1 2011 BUDGET OVERVIEW

Total revenue and grants in 2011 is K9,328.1 million. This is K1,083.6 million or 13.1 per cent higher than the 2010 revised estimate. This is primarily attributable to higher tax revenue of K850.0 million or 13.1 per cent from the revised 2010 estimate. Higher tax revenue is largely due to higher personal income and company taxes, which are increasing due to strong domestic economic growth and the ramp up in PNG LNG activity.

3.2 FISCAL STRATEGY

The 2011 Budget is framed against a background of global economic recovery and strong domestic economic growth due to the construction of the PNG LNG project and increased production from new and existing mines.

With the PNG economy in transition during the construction phase of the PNG LNG project, the Government has announced a balanced budget for 2011 to promote a stable macroeconomic and fiscal environment. This is consistent with the current high economic growth and also adheres to the existing overarching frameworks – the Medium Term Fiscal Strategy (MTFS), the Medium Term Debt Strategy (Debt Strategy), the Development Strategic Plan 2010 - 2030 (DSP), the Medium Term Development Plan (MTDP) and the *Fiscal Responsibility Act 2006*. This approach strikes a balance between the high number of expenditure pressures and development priorities, and the benefits of fiscal restraint in a strongly growing economy with capacity constraints.

The global economic recovery combined with the rebound in commodity prices in 2011 and increased production is expected to result in additional mineral revenue in 2011 (mineral revenue above 40 per cent of GDP). This triggers the MTFS rule which requires that 70.0 per cent of these revenues be allocated to public investments and 30.0 per cent to debt repayment. Given the critical development needs and to be consistent with the new DSP, the Government has allocated a higher portion of additional mineral revenues to public investments through the development budget to fund MTDP enablers, as identified in the first MTDP 2011 -2015. This will increase the development budget to record levels, following exceptional growth of 240 per cent over the past two years. The contribution to debt repayment in 2011 will be met through a payment of K127.0 million in superannuation arrears.

In recognition of PNG's development priorities and falls in general government debt as a share of GDP, the Government has modified the MTFS rule to allow 100 per cent of additional mineral revenues to be devoted to public investments in future budgets. However, this change will only apply if debt remains below 30.0 per cent of GDP. Corresponding changes to the *Fiscal Responsibility Act 2006* have been made to allow for some flexibility to borrow and run budget deficits when the economic circumstances permit.

On the expenditure side, both the recurrent and development budgets are focused on MTDP enablers to support the Government's aim of ***Building the Foundation for Economic Growth and Prosperity*** commencing 2011. The MTDP enablers include: unlocking land for development; universal access to quality primary and better secondary education; higher and technical education; establishing quality national road transport corridors that connect

rural education populations to markets and services; improved health outcomes; and improving law, order and justice.

To achieve a balanced budget, total expenditure and net lending has been increased to match the increased resource envelope. Much of the increases have been made to the Recurrent Budget largely to meet unavoidable obligations and to support key MTDP enablers. Significant allocations have been made to other major investment oriented programs including the Umbrella Benefit Sharing Arrangement (UBSA) commitments, District Service Improvement Program (DSIP), National Agriculture Development Program (NADP), Rehabilitation of Provincial Hospitals and National High Schools, Rural roads, Rural Electrification and Education Subsidies.

There will be no new taxes in the 2011 Budget. However, a number of taxation policy measures will be introduced aimed at promoting an efficient and competitive economy, ensuring healthy and improved living standards, safeguarding the environment and protecting the revenue base.

3.3 REVENUE AND GRANTS

Total revenue and grants have increased from K6,651.3 million in 2009 to K8,244.5 million in 2010, largely due to the significant increase in commodity prices following the recovery to the global economy. This has been supported by stronger domestic taxes, in particular personal income taxes, which has benefited from strong wages growth and solid employment. Grants are expected to increase from K877.5 million in 2009 to K1,293.9 million in 2010. This is attributed to the depreciation of the Kina against the Australian dollar and also increases in donor funding from AusAid. Table 1 provides a summary of revenue and grants movements.

Table 1: Revenue Summary Table 2009– 2011 (Kina Million)

	2009 Actual	2010 Budget	2010 Revised	2011 Projection
Total Tax Revenue	4,974.5	5,735.3	6,481.0	7,331.0
Growth on previous year (%)	-13.5	15.3	30.0	13.1
Per cent of GDP	22.4	22.2	25.1	25.5
Non-taxation Revenue	765.8	400.5	409.6	411.1
Growth on previous year (%)	171.0	-47.7	-46.5	0.4
Per cent of GDP	3.4	1.6	1.6	1.4
Grants	887.5	1,293.9	1,293.9	1,526.1
Growth on previous year (%)	-12.4	47.5	47.5	17.9
Per cent of GDP	4.0	5.0	5.0	5.3
Total Revenue and Grants	6,651.3	7,489.7	8,244.5	9,328.1
Growth on previous year (%)	-6.0	12.6	24.0	13.1
Per cent of GDP	30.0	29.0	31.9	32.4

Source: Department of Treasury

The revised total revenue and grants estimate in 2010 is K85.0 million higher than the Mid-Year Economic and Fiscal Outlook (MYEFO).

In 2011, total revenue and grants are projected to increase to K9,328.1 million or 13.1 per cent, largely due to higher personal income and company taxes, which are increasing due to strong domestic economic growth and the ramp up in PNG LNG activity. The continuation of strong wages growth and employment is likely to result in higher disposable incomes for households, which are expected to support higher consumption and import taxes. Furthermore, as mineral commodity prices are assumed to remain at 2010 levels and production levels are expected to be higher in 2011, this is expected to result in stronger mineral and petroleum revenue.

The remaining sections in this chapter provide further disaggregation by key revenue heads and sources of grants.

3.3.1 Revenue Estimates Disaggregation

Table 2: Tax Revenue 2009-2010 (Kina Million)

	2009 Actuals	2010 Budget	2010 Revised	2011 Projection	Change
Tax on Income and Profits	3,519.7	4,029.7	4,706.7	5,292.5	585.8
Dom. Taxes on Goods and Services	1,063.2	1,258.9	1,240.5	1,429.4	188.9
Taxes on International Trade	391.6	446.7	533.8	609.1	75.3
Tax Revenue	4,974.5	5,735.3	6,481.0	7,331.0	850.0

Source: Department of Treasury

Note: The change column represents the change from the 2011 projection against the 2010 revised estimates.

In 2010, tax revenue is expected to be K6,481.0 million, which is an increase of K1,506.5 million compared to 2009 outcomes. The revised estimate is K745.7 million or 13.0 per cent higher than the 2010 Budget projection, largely driven by an upward revision to taxes on income and profits and taxes on international trade, which is partially offset by an expected decline in domestic taxes on goods and services.

Compared to MYEFO, tax revenue has been revised up by K101.5 million in 2010.

In 2011, tax revenue is expected to increase by K850.0 million or 13.1 per cent from the revised 2010 estimates, largely driven by increases in taxes on income and profits, supported by higher domestic taxes on goods and services and taxes on international trade. This increase is in line with strong growth in the nominal economy.

Table 3: Taxes on Income and Profits 2009 – 2011 (Kina Million)

	2009 Actual	2010 Budget	2010 Revised	2011 Projection	Change
Personal Income Tax	1,241.8	1,420.2	1,497.4	1,727.1	229.7
Company Tax	1,121.4	1,107.7	1,219.7	1,401.9	182.3
Dividend Withholding Tax	244.4	180.5	275.6	298.0	22.4
Mining and Petroleum Tax	693.1	1,088.8	1,471.2	1,594.7	123.5
Interest Withholding Tax	32.0	25.0	42.4	42.4	-
Other Direct Tax	83.1	104.6	104.3	119.7	15.4
Gaming Tax	103.9	102.9	96.1	108.6	12.5
Taxes on Income and Profit	3,519.7	4,029.7	4,706.7	5,292.5	585.8

Source: Department of Treasury

In 2010, taxes on income and profits are expected to be K4,706.7 million, which is an increase of K1,187.0 million compared to 2009 outcomes. The most significant contribution to the increase was from mining and petroleum taxes and personal income taxes, which increased by K778.1 million and K255.6 million respectively.

The revised estimate for 2010 is K677.0 million or 16.8 per cent higher than projected in the 2010 Budget, largely reflecting an upward revision to mining and petroleum taxes of K382.4 million or 35.1 per cent, due to stronger than assumed commodity prices. Other significant upward revisions include personal income tax of K77.2 million or 5.4 per cent and company tax collections of K112.0 million or 10.1 per cent, based on higher collections to date and a stronger than anticipated outcome in 2009 for company taxes. Dividend Withholding Taxes is expected to be K95.1 million or 52.7 per cent higher, which reflects increased profits and dividend distributions by some companies.

Compared to MYEFO, taxes on income and profits are anticipated to be K49.4 million lower in 2010.

In 2011, taxes on income and profits are expected to be K585.8 million higher or 12.4 per cent than 2010. This is attributed to stronger personal and company tax with the expected ramp up in activity for the PNG LNG project and higher mining and petroleum taxes due to elevated commodity prices and stronger production for some of the major mines.

Table 4: Domestic Taxes on Goods and Services 2009-2011 (Kina Million)

	2009 Actual	2010 Budget	2010 Revised	2011 Projection	Change
Excise	354.7	417.1	421.4	483.9	62.4
GST	703.0	835.7	812.8	938.3	125.6
Mining Levy	-	-	-	-	-
Other Indirect	5.5	6.1	6.3	7.2	0.9
Dom. Taxes on Goods and Services	1,063.2	1,258.9	1,240.5	1,429.4	188.9

Source: Department of Treasury

In 2010, the revised estimate for domestic taxes on goods and services is K1,240.5 million, an increase of K177.3 million compared to 2009. The revised estimate is K18.4 million or 1.5 per cent lower than forecast in the 2010 Budget. This largely reflects a downward

revision to estimated GST collections of around K22.9 million, as IRC clears its backlog of refunds.

Compared to MYEFO, domestic taxes on goods and services are estimated to be K13.8 million higher in 2010.

In 2011, domestic taxes on goods and services are expected to be K188.9 million or 15.2 per cent higher than in 2010. This is mainly attributed to higher GST and domestic excise collections reflecting expected increase in consumption.

Table 5: Taxes on International Trade 2009 – 2011 (Kina Million)

	2009 Actual	2010 Budget	2010 Revised	2011 Projection	Change
Import Duty	143.7	168.1	189.7	218.0	28.2
Export Duty	108.7	122.3	153.9	172.2	18.3
Excise Duty on Imports	139.2	156.3	190.2	218.9	28.7
Taxes on International Trade	391.6	446.7	533.8	609.1	75.3

Source: Department of Treasury

In 2010, taxes on international trade are expected to be K533.8 million, an increase of K142.2 million from 2009 outcomes, due to improvements in trade following the global recession and stronger import growth. This revised estimate is projected to be K87.1 million or 19.5 per cent higher than the 2010 Budget projection, with export growth rebounding more than anticipated and higher imports.

In 2010, export duty on logs is expected to be K31.6 million or 25.8 per cent higher than the 2010 Budget estimate. This is primarily driven by higher export prices and volumes. Excise duty on imports are now expected to be K33.9 million or 21.7 per cent higher than originally expected due to strong import volumes.

Compared to MYEFO, taxes on international trade are estimated to be K38.4 million higher in 2010.

In 2011, taxes on international trade are expected to be K75.3 million or 14.1 per cent higher than in 2010. This increase is mainly attributed to higher import duty and excise duty on imports, with imports rising in line with strong business investment and rising consumption.

Table 6: Non-Tax Revenue 2009 – 2011 (Kina Million)

	2009 Actual	2010 Budget	2010 Revised	2011 Projection	Change
Property Income	138.0	285.2	299.1	289.4	-9.7
<i>Non-Mining Dividend</i>	0.0	55.0	38.5	0.0	-38.5
<i>Mining and Petroleum Dividend</i>	138.0	230.2	260.6	289.4	28.8
Interest and Fees from Lending	6.9	9.0	4.0	4.0	0.0
Other Non-Tax Revenue	99.9	106.3	106.5	117.7	11.1
Injection from Trust Account	521.0	0.0	0.0	0.0	0.0
Total Non Tax Revenue	765.8	400.5	409.6	411.1	1.5

Source: Department of Treasury

In 2010, total non-tax revenue is expected to be K409.6 million, a decrease of K356.2 million compared to the 2009 outcome. This is due to no injections from Trust Accounts. The revised estimate for 2010 is projected to be K9.1 million or 2.3 per cent higher than the 2010 Budget projection. This increase is attributable to higher mining and petroleum dividends more than offsetting lower non-mining dividends.

Mining dividends in 2010 are expected to be K30.4 million or 13.2 per cent higher than expected in the 2010 Budget. This is driven by higher than expected dividend payments from Ok Tedi which reflects stronger commodity prices.

Non-mining dividends in 2010 are expected to be K16.5 million or 30.0 per cent lower than anticipated in the 2010 Budget due to lower than forecast dividend payments.

In 2010, expected dividend payments from non-mining State assets are: K36.5 million from the Independent Public Business Corporation, compared to the K25.0 million expected in the 2010 Budget; none from the National Fisheries Authority, compared to the expected K10.0 million; K2.0 million from Petromin and none from the Bank of PNG, compared to the expected K20.0 million in the 2010 Budget.

Interest and fees from lending in 2010 is expected to be K4.0 million, which is K5.0 million lower than the 2010 Budget estimate, which reflects lower interest earned from trust accounts. Departmental revenue is estimated at K106.5 million in 2010 which is K2.0 million higher than anticipated due to an increase in departmental collections.

Compared to MYEFO, non-tax revenue is estimated to be K16.6 million lower in 2010.

In 2011, total non-tax revenue is expected to be K1.5 million or 0.4 per cent higher than in 2010, largely due to higher projected mining and petroleum dividends flowing on from improved mining production and strong prices. Partially offsetting this will be lower non-mining dividends due to the expectation that State Owned Enterprises will not be making dividend payments to the State.

3.3.2 Grants

Infrastructure Tax Credits (ITC) and Project grants have remained unchanged since Budget. Project Support Grants are forecast to be K1,293.9 million in 2010.

Project Support Grants for 2011 are expected to increase by K232.2 million 17.9 per cent in 2011. This increase largely reflects the depreciation of Kina against the Australian dollar and also an increase in AusAid grants.

Table 7: Grants by Sources (Kina Million)

	2010 Budget	2010 Revised	2011 Projection	Change
AusAID	881.3	881.3	1,070.6	189.3
JICA	47.3	47.3	91.8	44.5
European Union (EU)	164.2	164.2	144.9	-19.3
New Zealand	52.1	52.1	65.0	12.9
China	31.1	31.1	30.8	-0.4
United Nations (UN)	83.5	83.5	67.2	-16.2
Others	34.4	34.4	55.8	21.4
Total Project Grants	1,293.9	1,293.9	1,526.1	232.2

Source: Department of National Planning and Monitoring

3.4 MEDIUM TERM FISCAL OUTLOOK

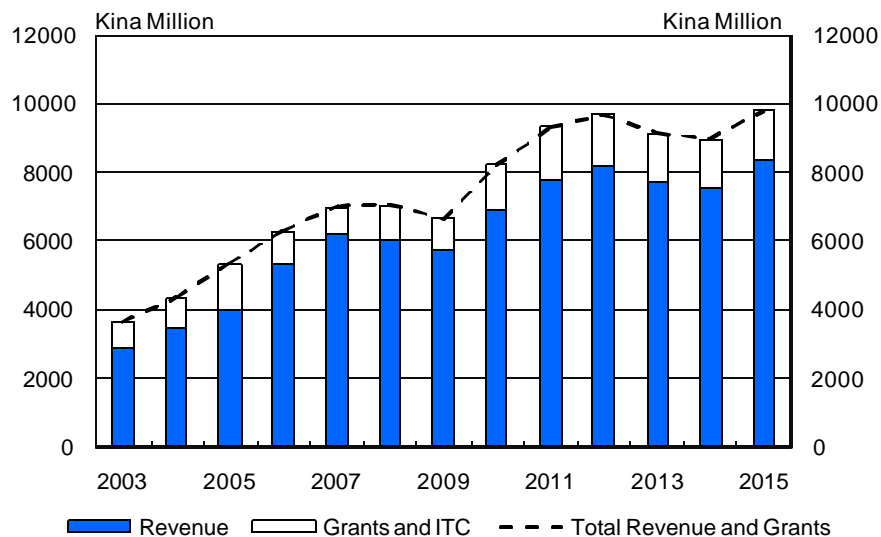
The 2011 Budget is framed against the Government's medium-term economic strategies: the Medium-Term Fiscal Strategy (MTFS), the Medium Term Development Plan (MTDP), and the Medium Term Debt Strategy. These are further guided by the *Fiscal Responsibility Act, 2006* (FRA) and the 2011 Budget Strategy Paper (BSP) that was approved by the National Executive Council on 31 July 2010.

The proposed 2011 Budget is a balanced budget to avoid ongoing budget deficits, especially in the light of strong economic growth, relatively high inflation and a substantial increase in government expenditure. There is a need for fiscal restraint via a balanced budget to maintain macroeconomic stability and investors' confidence.

Looking ahead over the period 2012-2015, the medium-term fiscal framework continues to reflect the current MTFS. The MTFS will be reviewed in 2011 and 2012, in conjunction with the Sovereign Wealth Fund framework for managing mineral and petroleum revenues including from the PNG LNG project. The next MTFS will be released before its commencement in 2013.

3.4.1 Revenue and Grants

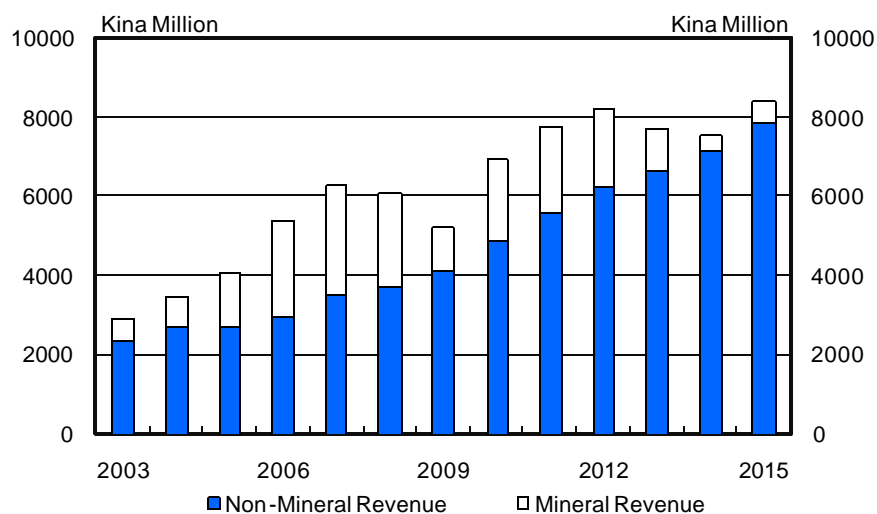
Total revenue and grants are expected to increase from 2011 to 2012 with the growth in economic activity and high mineral prices and production and then decline slightly from 2013 to 2014 as mining taxes received from Ok Tedi fall as the mine closes in 2014 and commodity prices are assumed to return to long-term prices. However, in 2015, total revenue and grants are expected to increase in line with the first payment of petroleum taxes from the PNG LNG project.

Figure 34: Total Revenue and Grants

Source: Department of Treasury

3.4.2 Revenue

Over the medium-term, total revenue is expected to increase at a gradual rate in line with increasing economic activity. Non-mineral revenues are expected to support total revenue as mineral revenue declines in 2013 and 2014— largely due to the assumption of commodity prices returning to long-term averages and declining production. However, total revenue is expected to increase with mineral revenue rising again as LNG production starts and revenue begins to flow from 2015 onwards.

Figure 35: Mineral and Non-Mineral Revenue

Source: Department of Treasury

3.4.3 Tax Revenue

Over the medium-term, tax revenue is projected to strengthen in 2012 and then decline moderately to 2014 before rebounding again in 2015.

In 2012, tax revenue is projected to increase by 6.4 per cent to K7,800.5 million, largely owing to an expected increase in Personal Income, Company and GST tax collections. This is driven by strong employment and solid wages growth from a buoyant economy.

The projected decline in 2013 and 2014 is largely due to the expected fall in collection of Mining and Petroleum Tax (MPT) and Dividend Withholding Tax (DWT). This reflects declining production from maturing oil fields, the slowdown of activity at OkTedi as it moves to expected closure in 2014 and the assumption that prices gradually return to long-run levels over the medium term. However in 2015, tax revenue is projected to pick up significantly, largely due to the expected first payment of Petroleum Income Tax from LNG sales. The increase in tax revenue growth in 2015 is also expected to be driven by high collection of Personal Income and Company Tax, combined with an expected increase in GST collections. This is expected to be driven by the strong pickup in economic activity generated by the direct and indirect benefits flowing from the PNG LNG project.

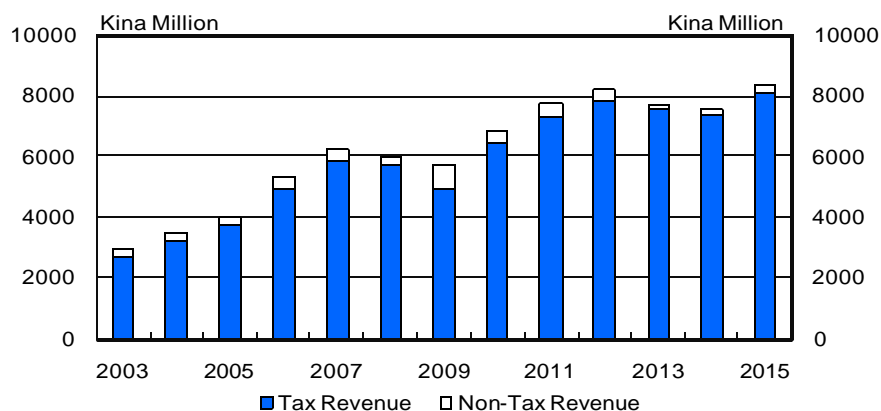
3.4.4 Non-Tax Revenue

The medium-term outlook for non tax revenue largely depends on the outlook on dividend payments from State Owned Enterprise (SOE) and Bank of PNG (BPNG) and equity investments owned by the State. These payments are largely driven by the profitability of SOE's, Government equity investments in Oil Search and OK Tedi and the state of BPNG's Balance Sheet and profitability.

Over the medium term, non-tax revenue is projected to continue to decline until 2013 and pick up in 2015. The decline in 2012 and 2013 is due to the expected fall in Mining and Petroleum Dividend payments from Ok Tedi as production winds down in 2014.

The expected pick up in 2015 is largely due to the first payment of petroleum dividends flowing from the sale of LNG in 2015.

Figure 36: Tax and Non Tax Revenue



Source: Department of Treasury

3.4.5 Grants

Grants are provided at the discretion of donors. The depreciation of Kina against most of the donor currencies, especially the Australian dollar in 2010 has increased the Kina value of grants significantly. In the outer years (2012-2015), grants have been held broadly in line with expected 2011 levels due to limited information provided by donor agencies.

CHAPTER 4. 2011 BUDGET: EXPENDITURE AND FINANCING

4.1 OVERVIEW

Total Expenditure and Net Lending in 2011 is estimated to be K9,328.2 million. This is K1,083.7 million or 13.1 per cent higher than the 2010 revised estimate, with substantial increases to both the Recurrent and Development Budgets.

Increased funding is provided to support Budget expenditure priorities and key Medium Term Development Plan (MTDP) enablers including: universal access to quality primary and better secondary education, higher and technical education, establishing quality national road transport corridors that connect rural populations to markets and services, improved health outcomes and improving law, order and justice. In addition, funds are required to settle outstanding court order payments, to meet superannuation obligations and for Public Employee Association (PEA) wage increases and other employee awards. Some of the increased funding will go to agencies that have important roles to deliver in supporting the PNG LNG project.

Table 8: Total Expenditure and Net Lending 2009–2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
Recurrent Expenditure	4,166.3	4,160.9	5,287.1	1,126.3	27.1
Development Expenditure	2,348.7	3,430.3	4,041.0	610.7	17.8
Reappropriation into Trust Account	172.5	0.0	0.0	0.0	
Supplementary Budget		653.3	0.0	-653.3	100.0
Total Expenditure & Net Lending	6,687.5	8,244.5	9,328.2	1,083.7	13.1

Source: Department of Treasury

4.2 RECURRENT BUDGET

The 2011 Recurrent Budget has increased by a substantial K1,126.3 million or 27.1 per cent from the revised 2010 estimate. The increase is shared evenly between Personnel Emoluments and Goods and Services. The Recurrent Budget has increased very little over the past two years and there is a need for a significant increase to support the development enablers and to meet unavoidable obligations.

Unlike the Development Budget which funds projects, the Recurrent Budget is responsible for funding the ongoing delivery of the essential services of Government. This Budget provides funding for teaching our children, employing health workers, providing medicines, maintaining our roads and for many other services which are important to all PNG citizens. In doing so, it also addresses the MTDP enablers, in particular:

1. Unlocking **land** for development;
2. Improving **law, order and justice**;
3. Establishing quality national **transport** corridors that connect rural populations to markets and services;

4. **Higher and technical education** to redress the severe skills shortage within PNG's labour force;
5. Universal access to quality **primary and secondary education**;
6. The provision of key **utilities** of electricity, clean water and sanitation and communications; and
7. Improving **health** outcomes.

In recent years, the Recurrent Budget has grown at a slower rate than inflation as the Government has sought to increase funding to the Development Budget, which grew by an exceptional 240.0 per cent over the last two years in 2010. This has reduced the ability of some agencies to deliver services and forced agencies to reprioritize funding. The 2011 Recurrent Budget seeks to address the pressures on basic service delivery and will increase by K1,126.3 million. Funding for many aspects of the Recurrent Budget is largely non-discretionary and additionally reflects already locked in public sector pay rises, restructures and other Government decisions.

Many factors have influenced the growth of the 2011 Recurrent Budget, a summary of major influences is set out below. This includes a reallocation from the Development Budget to the Recurrent Budget of K178 million for items that are ongoing in nature such as road maintenance.

a. **New Spending Decisions:** The Government has made the following new spending decisions in support of key MTDP enablers:

- Universal Access to quality primary and secondary education – additional funding of K149.1 million comprising:
 - Department of Education – additional K28.0 million for education subsidies; K30.0 million for curriculum supplies and K20.0 million for equipment; K7.3 million for expansion of examinations; and K2.25 million for 72 additional teachers in NCD.
 - Provinces - additional K42.8 million to fund an additional 4,000 teachers in 2011; and an increase of K7.7 million in basic education function grants.
 - Universities an additional K11.0 million for staff awards and additional staff.
- Establishing quality national transport corridors that connect rural populations to markets and services – additional funding of K46.7 million comprising:
 - Department of Works – National Road Maintenance will increase by K30.0 million to K60.0 million, and bridges maintenance will remain at K40.0 million (these items were previously funded in the development budget).
 - Provinces - transport infrastructure grants will rise by K16.7 million.
- Improving health outcomes – additional funding of K101.3 million comprising:
 - Department of Health - additional K35.0 million for the purchase of drugs; K28.0 million for additional medical equipment; and K4.1 million for doctors' pay increases.
 - Hospital Management Services - support for 17 provincial hospitals and 3 provincial health authorities via an extra 1,333 funded positions costing

K20.0 million, as well as ten new ambulances and three utilities at a cost of K1.5 million.

- Provinces - an increase in health function grants of K12.7 million.
- Improving law, order and justice – additional funding of K132.6 million comprising:
 - Police – K44.5 million extra, including K30.0 million for LNG support, to be paid through the Department of Public Enterprises, 630 new recruits for K3.8 million; and vehicles of K1.5 million.
 - Correctional Services – up K21.1 million, including for the new salary structure, new uniforms and 95 new recruits.
 - Department of Defence – K7.0 million for staff awards and to recruit 50 new officers, K7.0 million for liabilities, K2.5 million for training, K4.0 million for maintenance and K1.0 million for Beijing attaché.
 - Judiciary – additional K15.4 million for additional court circuits, a rebuilt official residence (K1.6 million) and vehicles for judges (K1.5 million).
 - Other – K20.0 million for a construction company settlement, land tribunals K6.0 million, and village courts of K1.0 million.

Other factors have also influenced the growth of the Recurrent budget. These include:

- b. **Indexation of Agency funding:** In 2011, National Departments' Goods and Services appropriations will be increased by K246.0 million or 8.0 per cent, and Statutory Authorities' appropriations will increase by K11.0 million or 5.0 per cent. Previously the indexation rate has been much lower for agencies and nil for Statutory Authorities bodies, causing significant cost pressures and a real reduction in funding.
- c. **Implementing the Reform of Inter-Governmental Financing Arrangements (RIGFA)** will provide Provinces with a further K43.0 million in support of service delivery for improved education, transport, health, utilities, law and order administration and agriculture outcomes.
- d. **True Cost of Payroll Reform:** As disclosed in the 2009 Final Budget Outcome and the 2010 MYEFO, overspending on Personnel Emoluments expenditures is a persistent problem affecting both National and Provincial Governments. Since 2001 Personnel Emolument expenditure has been on average K108.0 million or 9.1 per cent higher than forecast. This overspend is projected to continue in 2010.

A payroll overspend occurs when the actual cost of staff employed exceeds appropriations. Overspending is a widespread problem in provinces in particular and is the result of unbudgeted for mid-year increases in awards and allowances, excessive unattached officers, poor administration, fraud and structural underfunding of some agencies payroll costs.

In 2011, the Government will provide K75.0 million to address the historic underfunding of some agencies across Government. This will not fully fund overruns but will more fully reflect the true cost of staff on strength. The Department of Treasury and the Department of Personnel Management will also undertake further work to reform Personnel Emoluments arrangements in 2011.

- e. **Meeting structural adjustment and other obligations including PNG LNG project support:** Much of the Recurrent Budget relates to fixed costs of administering

government, and includes a large proportion of legal obligations. However, some of these have not been met in the past. This Budget attempts to remedy this by meeting the Government's superannuation obligations in 2011 of K220.0 million and part of its arrears from 2010 of K127.0 million. The Government will also partly fund its obligations for uniformed officers pensions (K10.0 million) and partly pay outstanding allowances for public servants previously employed on Bougainville (K10.0 million). It also includes a provision to fund the renegotiation of recently expired, or soon to expire, awards. In addition to Police support of K30.0 million to be provided through the Department of Public Enterprises (referenced above), K20.0 million has been provided for Treasury and K10.0 million for the Department of Public Enterprises to support Government involvement in the PNG LNG project.

The table below identifies the components of the 2011 Recurrent Budget.

Table 9: Recurrent Expenditure 2009–2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
Personnel Emoluments	1,778.1	1,952.9	2,494.2	541.3	27.7
Goods and Services	1,610.9	1,497.6	1,981.1	483.5	32.3
ABG	60.9	58.0	66.2	8.2	14.1
Transfers to Statutory Institutions	270.5	269.4	319.2	49.9	18.5
Interest Payments and Fees	449.2	387.0	430.4	43.4	11.2
Net Lending to CSAs	-3.3	-4.0	-4.0	0.0	0.0
Total Recurrent Expenditure	4,166.3	4,160.9	5,287.1	1,126.2	27.1

Source: Department of Treasury

4.2.1 Personnel Emoluments

Personnel Emoluments is comprised of salaries and allowances, wages, overtime, leave fares, superannuation contributions, superannuation pay outs, and contract gratuities. In 2011, total Personnel Emoluments for National Departments and Provincial Governments, including Teachers' Salaries, is estimated to increase by K541.3 million or 27.7 per cent compared to 2010.

The main factors driving the increase in Personnel emoluments are:

- Full funding of superannuation obligations for the first time of K220.0 million, with a further K127.0 million funding for part payment of arrears;
- The flow on costs of awards and agreements which were agreed or implemented in 2010. This is particularly relevant for agencies including Health, Hospital Management Services, Police, Correctional Services and Defence which entered into or implemented new award arrangements in 2010 or late 2009;
- Provision for anticipated wage increases for Public Service workers to be negotiated in late 2010 and 2011;
- Restructures, including upgrades in positions and increased allowances across various Government departments. In some cases these decisions have been made by Secretaries and agency heads using devolved human resource powers without proper reference to the availability of funds through the Budget; and
- Misuse of the centralized payroll management function has resulted in agencies and Provinces routinely exceeding appropriations. The critical enabler of the Personnel

Emoluments over-expenditure is the ALESCO Government Payroll System. ALESCO has no limit placed on payroll expenditure so agencies are able to over-expend their appropriations with no immediate impact on their budgets. The Government will be addressing this matter in 2011 through the introduction of more stringent monitoring and controls on the payroll system.

Table 10: Personnel Emoluments 2009–2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
National Departments	986.7	1,149.7	1,704.6	554.9	48.3
Provincial Governments	791.4	803.2	789.6	-13.6	-1.7
<i>Staffing Grants</i>	247.4	320.6	261.7	-58.9	-18.4
<i>Teachers Salaries</i>	544	482.6	527.8	45.2	9.4
Bougainville Government	37.7	38.0	44.7	6.7	17.6
Total Personnel Emoluments	1815.8	1,990.9	2,538.9	548.0	27.5

Source: Department of Treasury

The largest increases in Personnel Emoluments for National Departments in 2011 are attributable to Hospital Management Services (K16.8 million) and the Correctional Services (K17.4 million), as well as full superannuation funding of K220.0 million and the part payment of arrears owing for superannuation of K127.0 million.

The increase in Personnel Emoluments for Hospital Management Services is driven by increases in awards for hospital staff and other health workers (including Church Health Workers) and increased staff. The increase for Correctional Services reflects a new salary structure approved by the Salaries and Conditions Monitoring Committee. This is being undertaken as part of a broader organizational renewal.

In Provinces, an increase in Personnel Emoluments for Teachers of K42.8 million will support an additional 4,000 teachers in the Provinces. The three largest increases will be for Madang (K10.8 million), East Sepik (K13.7 million) and Southern Highlands (K12.8 million). The highest proportional increase is to Manus with an increase of 22.5 per cent to support the provision of ward development officers. The 2010 estimates reflect anticipated overspends as at the Mid Year Economic and Fiscal Outlook.

All major components of Personnel Emoluments in National Departments are expected to increase in 2011.

The provision of funding of superannuation in 2011 is for exit payments (K220.0 million), and to partially meet arrears from previous underfunding (K127.0 million).

**Table 11 : Personnel Emoluments – National Departments by Items 2009–2011
(Kina Million)**

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
Salaries	751.0	877.3	1,201.9	324.6	37.0
<i>Salaries and Allowances</i>	652.9	778.1	1,100.3	322.2	41.4
<i>Wages</i>	98.1	99.2	101.6	2.4	2.4
Superannuation	115.9	130.2	347.0	216.8	166.5
Leave Fares	48.9	50.9	57.1	6.2	12.2
Contract Gratuity	55.8	78.8	80.6	1.8	2.3
Others 1/	15.1	12.5	18.0	5.5	44.0
Total Personnel Emoluments	986.7	1,149.7	1,704.6	555.0	48.3

Source: Department of Treasury

¹ Includes overtime and contract officers' education benefit**4.2.2 Goods and Services**

Total expenditure for Goods and Services in 2011 is estimated to increase by K485.1 million or 32.0 per cent from the revised estimate for 2010. This follows negative growth in 2010 as funds were diverted to increase the size of the Development Budget.

Table 12: Goods and Services 2009–2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
National Departments	1,416.7	1,287.1	1,727.6	440.5	34.2
Provincial Governments	276.1	210.5	253.5	43.0	20.4
Bougainville Government	19.4	20.0	21.6	1.6	8.0
Total Goods and Services	1,712.2	1,517.6	2,002.7	485.1	32.0

Source: Department of Treasury

4.2.2.1 Goods and Services – National Departments

The total funding for National Department's Goods and Services for 2011 is estimated to increase by K440.5 million or 34.2 per cent from the revised estimate for 2010. The largest aspect of this increase is the indexation of Goods and Services funding for National Departments by 8.0 per cent (worth K246.0 million) in order to address cost pressures resulting from low indexation arrangements in prior years.

Major increases include:

- Increased funding for education subsidies of K28.0 million, bringing total funding to K172.0 million;
- Increased funding of K50.0 million for the purchase of curriculum supplies (K30.0 million) and secondary school equipment (K20.0 million);
- Increased funding for the purchase and distribution of drugs and health supplies of K25.0 million, bringing total funding to K132.0 million;
- Increased funding for the purchase of medical equipment of K28.0 million. This funding was previously included in the Development Budget but has now been transferred to the Recurrent Budget;

- Increased funding for Police via the Department of Public Enterprises of K30.0 million for LNG Project Support;
- Increased funding for Defence of K20.0 million for essential maintenance of equipment and training of Defence force members; and
- Increased funding for the Department of Works to K100.0 million, comprising K60.0 million for National Road Maintenance and K40.0 million for National Bridges Maintenance.

Table 13: National Departments Goods and Services 2009–2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
General Goods and Services	1,213.4	1,065.8	1,458.8	393.0	36.9
Education Subsidies	142.7	143.0	172.0	29.0	20.3
Other Goods and Services	60.6	78.3	96.9	18.6	23.8
<i>Structural Adjustments Program</i>	9	28.3	36.9	8.6	30.4
<i>Court Orders</i>	51.6	50.0	60.0	10.0	20.0
Total Nat Depts Goods & Services	1,416.7	1,287.1	1,727.7	440.6	34.2

Source: Department of Treasury

Table 14: General Goods and Services by Item 2009–2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
Operational Materials and Supplies ¹	452.5	369.4	560.1	190.7	51.6
Utilities	133.8	142.7	164.7	22.0	15.4
Rental of Property	124.8	128.9	155.7	26.8	20.8
Grants to Individuals and NPOs	75.6	71.9	97.5	25.6	35.5
Transport and Fuel	47.7	47.7	51.5	3.8	7.9
Travel and Subsistence	48.8	50.1	58.2	8.1	16.2
Routine Maintenance	30.8	34.1	42.2	8.1	23.8
Purchase of Vehicles	17.9	9.7	14.7	5.0	51.6
Membership Fees/Contributions	5.4	9.8	9.7	-0.1	-1.5
Other ²	276.1	201.5	304.5	103.0	51.1
Total Gen Goods & Services	1,213.4	1,065.8	1,458.8	393	36.9

Source: Department of Treasury

¹Includes other operational expenses²Other includes office furniture and equipment, training and administrative consultancy fees

4.2.2.2 Goods and Services – Provinces

The funding arrangements arising from the Review of Intergovernmental Financing Arrangements (RIGFA), which were passed by Parliament in 2009, provide the basis for determining the Provincial Goods and Services ceilings.

The new system provides that the total amount of any grants made to the Provincial Government will be equal to its individual province share. Because the Provincial Governments are different, they each need a different amount to deliver their assigned delivery functions and responsibilities. The amount that is needed is called the 'fiscal need'

amount. The fiscal need amount is a key component of the new system for distributing funding on an equalization basis. A provincial government's fiscal need amount is based on the cost of providing its assigned service delivery functions and responsibilities as well as the revenue already available to the Provincial Government to pay for those services.

A province's fiscal need consists of various grants, each earmarked for different sectors and their corresponding Goods and Services costs. The grants for Goods and Services costs associated with all of Provincial functions are:

- Administrative or Block Grant;
- Other Service Delivery;
- Education Function Grant;
- Health Function Grant;
- Transport Infrastructure Maintenance Grant;
- Village Court Function Grant;
- Primary production Function Grant
- Rural Local-Level Government Grants; and
- Town Services/Urban LLG Grants.

Table 15: Provincial Goods and Services Grants 2009–2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
Unconditional Grants	38.2	8.8	9.2	0.4	4.5
<i>Administrative / Block</i>	38.2	8.6	9.2	0.6	6.9
Conditional Grants	170.8	201.9	244.3	42.4	21.0
<i>Other Service Delivery</i>	14.8	15.3	17.2	1.9	12.4
<i>Health Function</i>	28.4	39.2	51.9	12.7	32.4
<i>Education Function</i>	31.6	38.9	46.6	7.7	19.8
<i>Transport Maintenance</i>	34.1	45.9	61.7	15.8	34.4
<i>Village Court Function</i>	2.2	2.2	2.3	0.1	4.5
<i>Primary Production Function</i>	14.1	14.1	16.9	2.8	19.9
<i>Local & Village Services</i>	33.7	34.2	35.1	0.9	2.6
<i>Town & Urban Services</i>	11.9	12.1	12.6	0.5	4.1
Total Provincial Goods and Serv	209.0	210.5	253.5	43.0	20.4

Source: Department of Treasury, National Economic and Fiscal Commission

Total Provincial Goods and Services grants are estimated to increase by K43.0 million or 20.4 per cent in 2011 compared to 2010.

4.2.2.3 Transfers to Autonomous Bougainville Government

Funding for the Autonomous Bougainville Government (ABG) in 2011 is projected to increase by K8.2 million or 14.1 per cent, in accordance with the indexing requirements set out in the *Organic Law on Peace-Building in Bougainville-Autonomous Bougainville Government and Bougainville Referendum*.

Table 16: Transfers to Autonomous Bougainville Government 2009-2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
Personnel Emoluments	37.7	38.0	44.6	6.6	17.4

<i>Staffing Grants</i>	10.6	10.9	10.9	0.0	0.0
<i>Teachers Salaries</i>	27.0	27.1	33.7	6.6	24.4
<i>Goods & Other Services</i>	19.4	20.0	21.6	1.6	8.0
<i>Police Goods & Services</i>	2.3	2.4	2.6	0.2	8.3
<i>Recurrent Goods and services</i>	16.8	17.3	18.7	1.4	8.1
<i>Conditional Grant</i>	0.3	0.3	0.3	0.0	0.0
Total ABG	57.1	58.0	66.2	8.2	14.1

Source: Department of Treasury

4.2.2.4 Transfers to Statutory Authorities

The 2011 Budget provides an increase in Statutory Authorities' funding of K49.8 million or 18.5 per cent compared to the revised estimate in the 2010 Budget.

Table 17: Transfers to Statutory Authorities 2009 – 2011 (Kina Million)

	2009 Act	2010 Est	2011 Proj	Change	Change (%)
Tertiary Institutions	91.2	94.1	109.7	15.6	16.5
<i>UPNG</i>	33.4	33.4	39.5	6.1	18.2
<i>University of Technology</i>	32	34.8	40.3	5.5	15.8
<i>University of Goroka</i>	12.6	12.2	13.7	1.5	12.3
<i>University of Natural Resources</i>	9	9.0	10.9	1.9	21.1
<i>Legal Training Institute</i>	1.5	1.8	2.3	0.5	27.8
<i>PNG Maritime College</i>	2.7	2.9	3.1	0.2	6.9
PNG Forest Authority	26	26	27.8	1.8	6.9
Civil Aviation Authority	3.5	9.6	10.1	0.5	5.2
National Broadcasting Commission	20.3	20.3	21.3	1.0	4.9
Ombudsman Commission	14	14	14.7	0.7	5.0
Office of Auditor General	14.2	14.6	16.2	1.6	10.9
Tourism Promotion Authority	9.8	9.8	10.3	0.5	5.1
National AIDS Council	5.7	6.4	6.9	0.5	7.8
National Training Council	2.5	2.5	2.6	0.1	4.0
PNG Sports Foundation	3.2	6.6	10.6	4.0	60.6
National Museum and Art Gallery	4.6	4.6	8.0	3.4	73.9
Office of Climate Change and Development	-	-	7.4	7.4	-
Coastal Fisheries Development Authority	-	-	2.4	2.4	-
Cocoa Coconut Institute	5.4	5.4	5.7	0.3	5.6
Accident Investigation Commission	-	-	3.1	3.1	-
Other	70.1	55.5	62.5	7.0	12.6
Total Transfers to Stat Authorities	270.5	269.4	319.2	49.8	18.5

Source: Department of Treasury

¹ Comprises NRI, NEFC, National Narcotic Bureau, Institute of Medical Research, National Youth Commission, IPA, SBDC, NISIT, ICDC, National Museum Authority, National Housing Commission, National Cultural Commission, Boarder Development Authority, CIC, NMSA, NAQIA, CCI, FPDA, NARI, NRA, ICCC and CLRC.

The Statutory Authorities that will receive increases in funding in the 2011 Budget include Tertiary Institutions (K15.6 million), PNG Sports Foundation (K4.0) million and the PNG

Forest Authority (K0.5 million). There is an allocation of K6.6 million in the 2011 Treasury Miscellaneous vote for payment of the PNG Forest Authority's contract with SGS log monitoring. This is consistent with previous years' treatment of this funding. There is also an allocation of K3.0 million in the 2011 Treasury Miscellaneous vote as payment for some of the National Broadcasting Commission's outstanding liabilities.

4.3 NON-FINANCIAL INSTRUCTIONS

To improve accountability and transparency, the Government has made a number of decisions in the Budget context for implementation in 2011. The results (where relevant) will be considered in the 2012 Budget process. These decisions are intended to improve the performance of the Public Service and ensure public money is spent appropriately and delivers the services that our citizens demand. These include:

Trust Fund Management – The Government will require agencies to report in the Budget process on public monies held in trust accounts managed or controlled by GoPNG entities including statutory authorities and departments.

- a) In preparing these reports agencies are required to:
 - i) Identify the balance of the trust account as at 30 August 2011;
 - ii) Identify and reconcile movements in the trust account balance up to 30 August 2011;
 - iii) Project movements in the trust account balance for the remainder of the 2011 year;
 - iv) Provide a detailed Budget describing how the funds held in trust are to be expended;
 - v) Provide details of interest earned on trust accounts; and
 - vi) Identify the legal authority for the creation and continuing operation of the trust account.

Off-Budget Income - The Government will work to ensure that proposed expenditure is externally scrutinised and is consistent with Government priorities. Agencies with income earned through providing government services (eg immigration permits, work permits, licences and the like) are required to submit to the Budget Screening Committee a complete budget identifying:

- b) Recurrent Budget revenue;
- c) Development Budget revenue; and
- d) Non-Budget funded revenues.

Retrenchment and Retirement - The Government noted the significant and ongoing costs of current retrenchment provisions, the cost of maintaining unattached officers on payroll pending provision of funds for their retrenchment or retirement, and the variation in approaches by agencies and provincial governments to redundancy and retirement action. The Government will require that agencies and Provinces be required to apply current funds or savings to meet the costs of genuine retrenchments and retirements before seeking Budget funding and to make greater use of existing disciplinary provisions in the case of underperforming or offending officers and that this policy be applied nationally.

Recruitment without financial resourcing - The Department of Personnel Management will investigate instances of agencies recruiting new staff without first securing the financial resources necessary to meet the salary costs of new appointees. In the event that there is evidence that the head of agency, or their sub delegate, has exceeded their powers, that

those devolved powers be withdrawn with appropriate sanctions applied to individual officers.

Provincial Governments' Payroll Management - The Government noted with concern a consistent trend among Provincial Governments to under budget for teachers' salaries and costs and to over expend on other salaries paid through the Alesco payroll system. The Government will ensure that:

- a) the Teacher Services Commission reviews Provincial Governments' approach to calculating teacher entitlements with a view to improving their accuracy; and
- b) Provincial Governments will be provided with simple graphical reports of staff numbers with current year to date and projected expenditure each fortnight. Provincial Governments will be required to confirm they have received each report and that they are satisfied expenditure is on track.

Compliance with the *Public Financial (Management) Act 1995 (PFMA)*: the Department Heads for Finance and Treasury will work to operationalise the sanctions available under the *Public Finances Management Act (PFMA)* to 'surcharge' agency heads who breach the provisions of the PFMA.

Public Service Housing - The continuing trend of agencies to enter into ad hoc housing arrangements is inconsistent with current public service employment conditions. The Government will suspend further ad hoc arrangements until a whole of government housing policy is developed. This policy is intended to be consistent with any Public Service employment conditions that may be developed. The Departments of Treasury, Personnel Management and Housing will report back to Government in 2011 with costed options for the development and implementation of any new housing policy.

Agency Payroll Debts to the Department of Finance - Finance and Treasury will report to the Budget Screening Committee in the context of the 2012 Budget on options to resolve the issue of outstanding payroll debts administered by the Finance Department for agencies and statutory bodies. Options should be informed by agencies' capacity to repay the debts.

Consultants and Professional Service Providers - The Government noted the contribution of consultants and professional service providers to the management of Government agencies. The Government is concerned at the long term nature and cost of many of these consultancy arrangements and has decided that agencies will report in the Budget Process identifying any consultancy exceeding six months or K150,000 total value (including all fees, allowances and gratuities);

1. Details of the specific task and timeframe the consultant is expected to undertake;
2. Why the task cannot be undertaken by agency staff;
3. Details of steps taken by the agency to address any skills gap and to reduce the reliance on external consultants; and
4. Details (including duration and cost) of all consultancy or professional service contracts, entered into by the agency in 2010 and 2011.

Agency Specific Decisions:

In addition to the above decisions which affect the whole of government, the Government has made a range of recommendations in relation to specific agencies. These include :

Calculation of leave travel entitlements (Department of Personnel Management) - The Government noted an absence of uniformity in the calculation of entitlements for leave fares involving land and water transportation with departments applying different methods. The Government has directed that the Department of Personnel Management will provide clear guidance to agencies and provincial administrations on this matter.

Utilities (Department of Environment) - The Government is concerned about the difficulties some agencies have in effectively managing the rising cost of utilities. The Department of Environment will provide advice and education to agencies on options to manage their resource consumption and reduce costs.

Membership of International Organisations (Department of Foreign Affairs and Trade) - PNG is a member of a wide range of international and regional organisations, often at a substantial cost in terms of membership fees and travel associated with meeting participation. The membership of all such organisations will be reviewed by an independent Government Committee chaired by the Department of Foreign Affairs and Trade, with a view to identifying those organisations where PNG participation had achieved specific, quantifiable outcomes of demonstrated value to PNG and the cessation of membership of organisations which fail to meet this test.

NASFUND (Treasury) - The financial health and strong financial position of NASFUND indicates there may no longer be a need to provide ongoing support to NASFUND. The Department of Treasury will discuss with NASFUND options and mechanisms for withdrawing GoPNG funding support for the entity.

Legal Training Institute - The Institute, the Department of Justice and Attorney General, together with the Department of Treasury, the PNG Law Society, the Judiciary, the University of PNG and other relevant stakeholders, will examine and provide fully costed options to the 2012 Budget Screening Government to increase the number of legal practitioners admitted to practice each year.

Department of Defence - The Department of Defence and the Treasury will jointly report back to the Budget Screening Committee in the 2012 Budget context with a detailed and fully costed Defence White Paper:

1. The options to be presented are to include high, medium and low cost options;
2. The cost of the options presented by Defence are to provide estimates of costs for the period 2011-2015; and
3. The Department of Treasury be consulted in the development and costing of the options to be presented to Government.

National Narcotics Bureau - The Government recognises the importance of the function of the National Narcotics Bureau (NNB). However, this function is not being effectively delivered and the Department of Personnel Management will review the operations and functions of the NNB, and make recommendations to assist it to deliver on its objectives.

PNG Fire Services - The Government noted that the PNG Fire Services would shortly require new specialist fire fighting equipment to attend to emergencies in the high rise buildings being constructed currently. The Government decided that the Fire Services will review the options for funding such purchases without drawing down on the Budget, in particular the imposition of a Fire Services Levy on the insurance premiums payable by high rise building owners. The Government noted that this option had been applied by several other jurisdictions in the region.

Solicitor General - Ineffective management of claims by agencies is a continuing problem and exposes the state to significant financial risk. The Office of the Solicitor General will develop a program to better educate agencies on options and strategies for managing current and future claims.

Independence Scholarships (National Training Council) - The Government noted that Independence Scholarships program had not been critically assessed for many years. It determined that this program be reviewed by the National Training Council with funding up to K200,000 to be held in Division 207 for this purpose.

National Road Authority (NRA) - The Government has ceased NRA's Recurrent Budget funding from 2011 as the agency receives significant off-Budget revenue from road user charges and should use these funds to meet its costs. The road user charge of 4t/l diesel levy collected on behalf of the NRA by the IRC is held in an off-Budget account with an approximate balance of K60.0 million as at September 2010. The road levy generates approximately K16.0 million annually.

Tourism Promotion Authority - The Government decided that the agency will develop a project plan during 2011 for the implementation of the Tourism Master Plan 2007-2017. TPA is to work with Treasury in developing this plan.

Border Development Authority - The Government noted that the Border Development Authority has established a commercial shipping arm, PNG Maritime Ltd, and is proposing its rapid expansion in 2011. The Government decided that no Government funds, either by way of appropriation or loan guarantee, should be considered for the commercial operation until a full feasibility study of PNG Maritime Ltd has been provided to Government, including the feasibility of alternative means of improving sea transport services, such as the subsidy of existing commercial operators.

4.4 INTEREST AND OTHER FEE PAYMENTS

Total interest and other fee payments are projected to be K430.4 million in 2011, an increase of K43.4 million or 11.0 per cent, from the revised estimate for 2010. The total payment is comprised of K369.5 million in domestic interest and fees outlays and K60.9 million in external interest and fees outlays.

Table 18: Interest & Other fee Payments 2009 – 2011 (Kina Million)

	2009 Act	2010 Rev	2011 Proj	Change	Change (%)
Domestic Interest Outlays	390.0	334.0	369.5	35.5	10.0
<i>Treasury Bills</i>	115.4	98.7	101.3	2.6	2.6
<i>Inscribed Stock¹</i>	270.7	235.0	267.7	32.7	13.9
<i>Other Domestic Debts</i>	0.9	0.0	0.0	0.0	0.0

<i>Agency Fees</i>	3.0	0.3	0.5	0.2	66.7
<i>External Interest Outlays</i>	59.2	53.0	60.9	7.9	14.9
<i>Interest</i>	55.6	49.8	47.4	-2.4	-4.8
<i>Other Fees</i>	3.6	3.2	13.5	10.3	321.9
Total Interest & Other Fees	449.2	387.0	430.4	43.4	11.2

Source: Department of Treasury

* Premiums on Inscribed Stock are treated as a negative interest outlay.

Domestic interest and fee payments are forecast to rise by K35.5 million in 2011 to K369.5 million. The increased payments reflect a projected increase in Treasury Bill and Inscribed Stock yields.

External interest and fee payments are projected to be K60.9 million in 2011, K7.9 million higher than the revised estimate for 2010. This largely reflects projected fees payable to Exim Bank of China of K5.9 million for a number of loans to fund development projects.

4.5 DEVELOPMENT EXPENDITURE

All major funding sources for the Development Budget including Direct Government Funding, Project Grants and Concessional Loans are expected to increase substantially in 2011. The large increase reflects the Government's commitment to investing in projects that will further PNG's development, increase the capacity of the rural economy and provide employment opportunities for Papua New Guineans.

Direct Government Domestic Funding continues to provide an increasing contribution to the Development Budget. In 2011, Domestic Funding is estimated to increase by K259.1 million or 13.9 per cent from the revised 2010 Budget.

Project Grants are expected to increase by K232.2 million or 17.9 per cent in 2011. This is due largely to the depreciation of the Kina against major currencies, particularly the Australian dollar. Infrastructure Tax Credits remain the same as in the 2010 Budget at K60.0 million.

Table 19: Development Expenditure: By Source 2009–2011 (Kina Million)

	2009 Act	2010 Rev	2011 Proj	Change	Change (%)
Government	1,382.1	1,867.5	2,126.6	259.1	13.9
<i>Domestic Funding</i>	1,348.6	1,807.5	2,066.6	259.1	14.3
<i>Infrastructure Tax Credit</i>	33.5	60.0	60.0	0.0	0.0
Loans	89.1	268.9	388.4	119.5	44.4
<i>Concessional</i>	89.1	268.9	388.4	119.5	44.4
<i>Commercial</i>	0.0	0.0	0.0	0.0	
Donor	877.5	1,293.9	1,526.1	232.2	17.9
<i>Project Grants</i>	877.5	1,293.9	1,526.1	232.2	17.9
Total Development Expenditure	2,348.7	3,430.3	4,041.1	610.8	17.8

Source: Department of Treasury

¹APE of K502.0 million is included in the Development Budget in 2011

Total Loans are also expected to increase by K119.5 million or 44.4 per cent in 2011. This reflects the large pipeline of new projects.

Further details of the 2011 Development Budget can be found in Chapters 6 and 7 of this Volume.

4.6 FINANCING

Net Government financing in 2011 is expected to be zero due to a projected budget balance. Net financing is comprised of an increase in expected net external financing of K183.0 million and an offsetting reduction in domestic debt by the same amount.

Consistent with the Medium Term Debt Strategy, the key elements of the Government's Debt Strategy 2011-2015 are:

- Maintaining debt at sustainable levels;
- Maintaining financial risks at prudent levels; and
- Developing the domestic debt market.

The Government financing strategy is an important element of its overall strategy for achieving macroeconomic stability over the medium term.

4.6.1 External Financing

Total new external borrowing of K183.0 million is expected to be undertaken in 2011. The repayment (amortization) of existing loans of K205.4 million is expected to be less than the new borrowing the government intends to undertake in 2011 of K388.4 million, resulting in a net external financing of K183.0 million.

The government will continue to drawdown on loans with international financial institutions, as long as the expenditures are consistent with Government priorities and are within the Budget ceiling. This means the Government's external borrowing will be driven by the MTFs (2008-2012), the *Fiscal Responsibility Act 2006* and the Debt Strategy. No external commercial borrowing is required to fund the 2011 Budget.

4.6.2 Domestic Financing

Repayment or amortization of existing domestic loans of K1,980.3 million in 2011 is expected to more than offset the total new domestic borrowing of K1,797.3 million, bringing down net domestic debt by K183.0 million.

No receipts from asset sales have been factored into financing the 2011 budget.

In 2011, the Government will continue with the inscribed stock program and maintain issuance of Treasury Bills with maturities of 182 and 364 days. This is consistent with the Government's Medium Term Debt Strategy objectives of lengthening the maturity of Government debt, in order to manage and reduce rollover, refinancing and foreign exchange risk. This should considerably strengthen the Government's financial position.

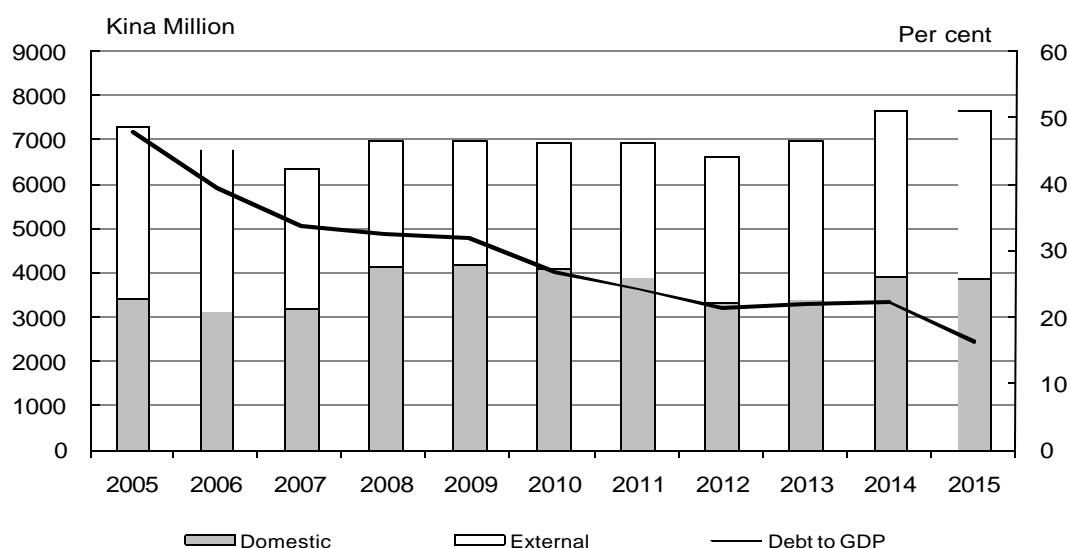
4.7 PUBLIC DEBT

Total public debt increased slightly from K6,938.0 million in 2008 to K6,944.1 million at the end of 2009 as a result of a small budget deficit. However, debt as a per cent of GDP fell from 32.1 per cent to 31.3 per cent reflecting moderate growth in GDP.

By the end of 2010, total public debt is expected to decrease slightly due to exchange rate movements to K6,914.3 million or 26.7 per cent of GDP.

Over the 5 years to 2008, the debt to GDP ratio fell significantly and is approaching a sustainable level.

Figure 37: Public Debt 2005 - 2015 (Per cent of GDP)



Source: Department of Treasury

4.7.1 Domestic Debt

At the end of 2009 the stock of domestic debt was K4,155.9 million, an increase of K72.8 million or 1.8 per cent over a year earlier. The stock of domestic debt at the end of 2010 is expected to be K4,066.9 million, a decrease of K89.0 million or 2.1 per cent from the previous year.

The Inscribed Stock issuance program which the Government has undertaken since 2006 has been successful in meeting the objective of lengthening the maturity of domestic debt, thereby reducing the refinancing risks. The proportion of Treasury Bills is expected to be 36.4 per cent at the end of 2010 down from 42.5 per cent in 2009.

4.7.2 External Debt

Total external debt at the end of 2009 was K2,788.2 million. This represents a decline of K66.7 million or 2.4 per cent from the level at the end of 2008. External debt is expected to increase in 2010 by K59.1 million or 2.1 per cent to be K2,847.3 million by year end. The projected increase in 2010 is largely due to expected projected draw downs of K268.9 million exceeding expected principal repayments of K184.6 million.

The Government remains committed to maintaining external debt at sustainable levels, however small increases in the level of external debt are anticipated over the medium term mainly due to the commencement of capital works on several large-scale infrastructure projects.

External debt continues to be dominated by debts to international agencies (multilateral and bilateral creditors) who account for 97.3 per cent of external debt as at year – end 2010, with commercial loans accounting for the remaining 2.7 per cent.

Box 1: GOVERNMENTS UNFUNDED SUPERANNUATION LIABILITY

Like all employers, the Government has an obligation to provide superannuation to its employees. Under the *Superannuation (General Provisions) Act 2000*, the Government is required to remit the full 8.4 per cent of its employer superannuation contributions beginning 2009 onwards at the time the liability to pay superannuation contributions occur. In the past, the Government has not provided superannuation contributions for employees on an ongoing basis as the liability accrues. This has led to an accumulation of *unfunded superannuation liabilities*.

The Government's unfunded superannuation liabilities can grow in two ways: the first way is if the Government is not paying into the fund the full contributions each year as the liability occurs; and the second way is that the size of the Government's liability to the fund grows in line with the rate of return of the superannuation fund.

While the Government's unfunded superannuation liability is a legitimate liability of the Government, it is not recognised as an official Government debt on the Government's balance sheet. While many countries around the world have unfunded superannuation liabilities, some countries elect to fully or partially reducing these liabilities.

If the Government fully funds its superannuation obligations, its actions will not add to unfunded superannuation liabilities, although if not paid, these liabilities will continue to grow in line with the rate of return on the fund.

The Government did not fully fund its employer superannuation obligations (composed of both contributions and exit payments) in the 2009 Budget and 2010 Budget. This means that Government did not conform with its own legislation, the *Superannuation (General Provisions) Act 2000*, which can result in penalties for non-compliance. There are also provisions for penalty interest payments to the superannuation fund (Nambawan Super).

At the end of 2009, the estimated size of the Government's unfunded superannuation liability has increased to K2,036 million as reported in Nambawan Super's 2009 annual report. A significant factor behind the growth in the unfunded liability over recent years has been Nambawan Super's extraordinary return in 2007 of 32.0 per cent crediting rate to members, followed by a solid 11.5 per cent in 2008 and 10 per cent in 2009. As a result of these returns, the Government's unfunded liability has increased in recent years even after taking into account the Government's earlier lump sum payments in 2007 (K250.0 million) and 2008 (K190.0 million).

A recent and avoidable factor that has further contributed to the growth in the unfunded liability is the Government's underfunding in the 2009 Budget which is estimated to cost K107.0 million (for both employee and exit payments) as at 31st December 2009. In addition, insufficient provision was made in the 2010 Budget resulting in the Government's 2010 superannuation obligations still outstanding.

For 2011, the Government has allocated K347.0 million to meet exit payments of K220.0 million and to partially meet arrears from previous under funding of K127.0 million.

From a fiscal sustainability perspective, this decision is welcomed as underfunding ongoing superannuation obligations is both undesirable and unsustainable and should be fully funded in future budgets. That said, the unfunded liability can be repaid in good times (surpluses when available) but does not have to be an ongoing burden on the budget in normal or difficult times.

Treasury has canvassed some possible approaches to potentially address this issue, all of which would require policy approval from Government, and a valid appropriation, given the Government's previous direction.

Although the Government should consider options to address this liability, this accrued unfunded liability need not be recognised as a debt due to its wider circumstances. Considering this, the first priority is for the Government to fully fund its employer contribution as required by the superannuation legislation. The second priority is to possibly consider provisioning for the unfunded liability through the Budget. This can occur without formally recognising the unfunded superannuation liability as a debt in order to allow Government to retain flexibility and balance against competing expenditure priorities and prevailing macroeconomic circumstances.

4.8 2010 SUPPLEMENTARY BUDGET

The 2010 Supplementary Budget maintains a balanced budget in accordance with the 2010 Budget Strategy, the Medium Term Fiscal Strategy (MTFS) and the *Fiscal Responsibility Act 2006* (FRA).

The revised estimate for 2010 is K653.3 million. The surplus is attributable to additional tax revenue and lower than expected interest payments on debt. The additional tax revenue largely reflects higher mining and petroleum taxes flowing from stronger commodity prices and slightly higher taxes on international trade.

As a result, there is the capacity for additional spending of K653.3 million while achieving the 2010 Budget strategy of a balanced budget. However, under the *Public Finances (Management) Act, 1995*, there can be no spending of money or transfer of money into trust without an appropriation from Parliament. Therefore, a Supplementary Budget is required to fulfil this requirement.

The table below provides a summary of the 2010 Supplementary Budget allocation.

Table 20: 2010 Supplementary Budget Allocation (Kina Millions)

Item	2010 Supplementary
LNG Related Commitments	170.0
PNG LNG High Impact Infrastructure Projects	40.0
PNG LNG Related MOA's	100.0
ILG and issues Committee	20.0
Police LNG Support	10.0
Roads	270.0
Highlands Highway	100.0
Lae Roads	50.0
Port Moresby Roads	70.0

Item	2010 Supplementary
Rural District Roads	50.0
Government Administration & Services	75.0
Provincial Services Improvement Programme	40.0
Electoral Commission	10.0
PM's Department	5.0
National Parliament	20.0
Business & Investment	52.0
Business Growth Centres	20.0
Small Business Development Cooperation	10.0
Cooperative Societies Programme	2.0
National Development Bank Equity Retail Banking	20.0
Miscellaneous	86.3
District Offices Rehabilitation	30.0
Internal Revenue Commission (Income Tax Refund)	15.0
Prime Minister's commitment (Coastal Areas)	10.0
Defence Ex-Servicemen Entitlements	9.0
REDD Program	3.3
Incentive Fund Support	3.0
Audit & Legal Team Support- Finance Department	2.0
Bainik University (Via Vudal University)	2.0
Mining Office Rehabilitation	2.0
Variarata National Park Rehabilitation	1.0
Mining Legal Costs	2.0
Mobile Police Barracks	5.0
CIS - Prison Industries Programme	2.0
Total	653.3

Source: Department of Treasury

The 2010 Supplementary Budget allocates a significant portion of additional funding to the PNG LNG Umbrella Benefits Sharing Agreement (UBSA) commitments and the maintenance of key roads, and will significantly increase the domestic component of the Development Budget. In addition, the 2010 Supplementary Budget allocates funding to Government administration and services; Business and Investment and Miscellaneous items.

The UBSA allocation is a demonstration of the Government's commitment to see the PNG LNG project proceed, and will give confidence to landowners, relevant provincial governments and project investors. Some parts of the UBSA commitments have been funded in the 2009 and 2010 Budgets. The following table provides an overview of the funding of UBSA related commitments.

Table 21 : PNG LNG UBSA related Commitments (Kina Millions)

Description	2010 Budget	2010 Supplementary	2011 Budget
Business Development Grant (BDG)	120.0		
Infrastructure Development Grant (IDG)	120.0		120.0
High Impact Infrastructure Projects (HIIP)		40.0	100.0
Feasibility Studies for high impact projects	5.0		
PNG LNG Related MOA's		100.0	32.1
Total	245.0	140.0	252.1

Source: Department of Treasury

4.8.1 UBSA/LBBSA commitments and other LNG related expenses

The Government has sought to honour its UBSA and Licensed Based Benefit Sharing Agreement (LBBSA) commitments by allocating significant funding to this purpose to support the smooth construction of the PNG LNG project. By funding these commitments now, there will be additional resources in future years for other development priorities.

A total of K170.0 million is allocated for PNG LNG related commitments in the 2010 Supplementary Budget. Of this, K40 million is allocated to the High Impact Infrastructure Projects (HIIP), K100 million to LNG Related MOA's which will settle outstanding amounts owed under MOA's, K10 million to Police LNG Support to ensure law and order in the LNG affected provinces and K20 million is allocated to Incorporated Land Groups (ILG) issues committee to assist landowner groups in the LNG project area to form for purposes of identifying land boundaries and landowners.

4.8.2 Road maintenance

According to the recently approved Development Strategic Plan (DSP), about 25,000 kilometres of roads in PNG should be in "good" condition by 2030. The Department of Works (DoW) estimates that a total of K145.0 billion is needed over the next 20 years to achieve this objective. Roads support PNG's economic development and enable producers to have access to national and global markets. It is important that current roads are well maintained to reduce further damage to road infrastructure and to facilitate the flow of goods to and from rural areas of PNG. Therefore K270.0 million is allocated to road maintenance in the 2010 Supplementary Budget.

Of this K270.0 million, K100.0 million is allocated to the Highlands Highway, which is critical to the construction of the PNG LNG project and many other industries.

A total of K70.0 million is appropriated to maintain the road network in Port Moresby due to the increased congestion and traffic associated with the PNG LNG project. The rapid capacity assessment suggests that NCD roads will suffer significant deterioration.

Continuous rain and neglect has left Lae city roads in a deteriorated state, therefore K50.0 million is appropriated to Lae Roads. As Lae is considered the industrial centre of PNG, providing adequate funds will assist in containing costs to business and investors.

A further K50.0 million is allocated for the maintenance of Rural District Roads.

4.8.3 Government Administration & Services

A total of K75.0 million is allocated to fund Government administration and services. These include K40.0 million for the Provincial Service Improvement Program, K20.0 million for the National Parliament, K10.0 million for the Electoral Commission, and K5.0 million for the Prime Minister's Department.

4.8.4 Business Investment

A total of K52.0 million is allocated to promote business investment. This is comprised of K20.0 million for Business Growth Centres, K20.0 million for National Development Bank Equity Retail Banking, K10.0 million for Small Business Development Cooperation and K2.0 million for Cooperative Societies.

4.8.5 Miscellaneous

This category includes minor funding priorities. A total of K86.3 million is to be provided for items that fall under the miscellaneous category.

Given that it is too late in 2010 to expend most of these funds, a large majority will be set aside in trust accounts as in previous years. To assist in managing liquidity issues, these funds will be held in trust accounts at the Bank of PNG. Further details are provided in Chapter 5.

CHAPTER 5. STATUS OF TRUST ACCOUNTS

5.1 OVERVIEW

This chapter provides a summary of movements in supplementary budget trust accounts (trust accounts) as at 30 September 2010. These trust accounts contain funds appropriated through additional priority expenditure (APE), supplementary budget expenditure (SBE) and annual Budgets, predominantly from additional mineral revenue from the commodity boom of 2005 to 2008.

As outlined in the Medium Term Fiscal Strategy 2008-2012, the purpose of holding funds in trust accounts is to spread public investment spending over time to manage inflationary and demand pressures in the economy and to provide time for implementing agencies to properly design implementation strategies.

The closing balance as at 30 September 2010 was a total of K951.1 million. Outstanding appropriations for trust include K415.0 million from the 2010 Budget, K40 million from 2010 Budget reappropriation and a further K552.3 million from the 2010 Supplementary Budget. A total of K723.2 million is appropriated for trust accounts in the 2011 Budget. Total payments from trust accounts from 1 January to 30 September 2010 is K736.6 million.

5.2 SUMMARY OF TRUST ACCOUNT MOVEMENTS

A total of K4,569.5 million, up to and including the 2010 Budget, has been paid into Supplementary Budget Trust Accounts for implementation of priority programs. The vast majority of this comprises appropriations from Supplementary Budgets and APE, and the remainder is from the 2008, 2009 and 2010 Recurrent and Development Budgets and bank interest. Table 22 provides a summary on the movement of funds in and out of Supplementary Budget Trust Accounts from 2005 to 2010.

Table 22: Summary of Trust Accounts movements since 2005 – 2010 (Kina Million)

Year	Deposits from SBE & APE ¹	Deposits from Annual Budgets & Interest	Spending from Trust Accounts	Net Savings(Deposits less Spending)
2005	400.0		0.0	400.0
2006	568.4		0.0	568.4
2007	1,283.0		76.0	1,207.0
2008	1,501.4	36.5	480.5	1,057.4
2009 ²	0.0	627.2	2,365.9	-1,738.7
2010 (Jan-Sep) ³	0.0	153.0	696.6	-465.1

Source: Department of Finance and Department of Treasury

(1) Prior to 2010, APE was either paid directly into trust accounts or spent directly through the recurrent and development budgets. From 2010 onwards, all additional priority expenditure will be spent through the development budget, and hence are shown as deposits from the annual budget.

(2) Trust Account spending in 2009 and the closing balance on the 31 December 2009 have been revised since 2009 FBO to account for additional spending of K4.2 million from the National Infrastructure Development Trust Account.

(3) Deposits and spending from trust accounts in 2010 exclude an intra-trust transfer of K40 million.

The last column of Table 22 above shows the broad fiscal impact of movements in trust accounts. A positive figure indicates that deposits exceed expenditure (or net government savings in trust accounts), which lessens the fiscal stimulus of Government spending. A negative figure indicates that expenditure exceeds deposits (or net government dissaving in trust accounts), thereby exerting additional fiscal stimulus to the economy. (In practice, expenditure from trust is often paid into the bank accounts of spending agencies, in which case there may be a further delay before the money is actually spent.)

The effect of trust accounts to lessen fiscal stimulus during the commodity boom of 2005 to 2008 (a period of above-average economic growth) contributed positively to economic and fiscal stability during this period. The provision of some additional fiscal stimulus was appropriate in 2009 following the onset of global finance crisis and global recession, although the scale of the stimulus (at over 10 per cent of GDP) was highly inappropriate. It is likely that a large portion of the funds expended from trust in 2009 were shifted to subsidiary accounts held by the spending agencies, as there is little evidence of the economic impact of this scale of expenditure. The expected return in 2010 and 2011 to trust account spending well within the limits of the Medium Term Fiscal Strategy is appropriate for an economy experiencing very high rates of economic growth and capacity constraints.

5.3 APPROPRIATION FOR TRUST ACCOUNTS: 2010 - 2011

A total of K1,160.3 million has been appropriated for trust accounts in the 2010 Budget and 2010 Supplementary Budget. This includes the K40.0 million reappropriation from the 2010 Budget to trust accounts (K10 million for 2011 National Census & K30 million for Provincial Government members entitlements). This allows the expenditure to occur past the end of the 2010 financial year due to the delays in the planned expenditure.

Of the K568.0 million appropriated for trust accounts in the 2010 Budget, K153.0 million has been paid into trust account as at 30 September 2010, with the remaining balance yet to be released into trust accounts in 2010.

A further K723.2 million has been appropriated for trust accounts in the 2011 Budget.

Table 23: Trust Account Appropriations and Payments 2010 - 2011 (Kina Million)

Expenditure Programs	Appropriation into Trust Accounts	Amount paid	Amount yet to be released
2010 BUDGET/ADDITIONAL PRIORITY EXPENDITURE			
District Services Improvement Program	178.0	106.0	72.0
Infrastructure Development Grant (UBSA)	120.0	0.0	120.0
Business Development Grant (UBSA)	60.0	47.0	13.0
Coastal Vessels Program	50.0	0.0	50.0
Rehabilitation of Transport infrastructure	40.0	0.0	40.0
Rural Electrification Program	40.0	0.0	40.0
National Roads - Missing Links	40.0	0.0	40.0
Coastal Fisheries	20.0	0.0	20.0
Waigani Office Redevelopment	15.0	0.0	15.0
Land Reform Program	5.0	0.0	5.0

2011 Budget, Volume 1

Expenditure Programs	Appropriation into Trust Accounts	Amount paid	Amount yet to be released
TOTAL	568.0	153.0	415.0
2010 BUDGET REAPPROPRIATION			
Provincial Government Members' entitlements	30.0	0.0	0.0
2011 National Census	10.0	0.0	0.0
TOTAL	40.0	0.0	0.0
2010 SUPPLEMENTARY BUDGET			
Infrastructure Development (MRDC)	100.0	0.0	0.0
Highlands Highway Rehabilitation	100.0	0.0	0.0
Hubert Murray Highway Upgrading Project	70.0	0.0	0.0
Transport Sector – Lae City Roads	50.0	0.0	0.0
Transport Sector – Rural District Roads	50.0	0.0	0.0
Provincial Services Improvement Program	40.0	0.0	0.0
PNG LNG High Impact Infrastructure Projects	40.0	0.0	0.0
Regional Finance & District Administrators Offices Establishment	30.0	0.0	0.0
ILG and Issues Committee	20.0	0.0	0.0
Business Growth Centres	20.0	0.0	0.0
National Parliament Infrastructure Rehabilitation	10.0	0.0	0.0
Mobile Police Barracks	5.0	0.0	0.0
Reducing Emissions from Deforestation & Degradation (REDD) Program	3.3	0.0	0.0
Incentive Fund Support	3.0	0.0	0.0
Department of Finance – Audit and Legal Team Support	2.0	0.0	0.0
Corrective Institutional Services- Prison Industries Program	2.0	0.0	0.0
Mining Legal Cost	2.0	0.0	0.0
Mining Office Rehabilitation	2.0	0.0	0.0
Cooperative Societies Establishment	2.0	0.0	0.0
Variarata National Park Rehabilitation	1.0	0.0	0.0
TOTAL	552.3		
2011 BUDGET/ADDITIONAL PRIORITY EXPENDITURE			
District Services Improvement Program	178.0	0.0	0.0
Infrastructure Development Grant (UBSA)	120.0	0.0	0.0
High Impact Projects – Southern Highlands (UBSA)	100.0	0.0	0.0
Rehabilitation of Education Sector Infrastructure (RESI)	70.0	0.0	0.0
Economic Corridor Development Program	50.0	0.0	0.0
Baiyer – Madang Road	20.0	0.0	0.0
Bogia – Angoram Road	20.0	0.0	0.0
Kokopau to Arawa Road Upgrading and Bitumen Sealing	20.0	0.0	0.0

Expenditure Programs	Appropriation into Trust Accounts	Amount paid	Amount yet to be released
Public Relation for Promotion of Government Initiatives	20.0	0.0	0.0
Coastal Vessels Program [New]	20.0	0.0	0.0
Coastal Fisheries Development Program	15.0	0.0	0.0
Lihir Special Support Grant	10.2	0.0	0.0
Aiyura NHS – Renovation and Upgrading	10.0	0.0	0.0
Kerevat NHS – Renovation and Upgrading	10.0	0.0	0.0
Passam NHS – Renovation and Upgrading	10.0	0.0	0.0
Sogeri NHS – Renovation and Upgrading	10.0	0.0	0.0
Trans Sepik Highway	10.0	0.0	0.0
Trans East - West New Britain Highway	10.0	0.0	0.0
Buluminski Highway	10.0	0.0	0.0
Central - Malalaua Highway	10.0	0.0	0.0
TOTAL	723.2	0.0	0.0

Source: Department of Treasury

5.4 TRUST ACCOUNT FUND MOVEMENTS IN 2010

Total expenditure from Trust Accounts from 1 January to 30 September 2010 totaled K736.6 million (K696.6 million after excluding intra-trust transfer), or 2.8 per cent of GDP. Trust Account spending has moderated in 2010 compared to the spending in 2009, which was about 10.8 per cent of GDP. Table 24 shows the Trust Account transactions from 1 January up to 30 September 2010, and the balances of the Trust Accounts as at 30 September 2010.

**Table 24: Trust Account Movements from 1 January to 30 September 2010
(Kina Million)**

Description	Opening Balance as at 1-Jan-2010 (2)	Debit (Receipt)	Credit (Payment)	Closing Balance as at 30-Sep-2010	Deposits Outstanding as at 30-Sep-2010
Gas Commercialisation Equity Financing	0.0	0.0	0.0	0.0	0.0
Agriculture Sector Development	2.2	0.0	-2.2	0.0	0.0
Airport Repairs and Upgrades	0.1	0.0	-0.1	0.0	0.0
Kubalia High School Rehabilitation	0.0	0.0	0.0	0.0	0.0
Outstanding PBSS (Teachers)	24.6	0.0	-24.6	0.0	0.0
Education Sector Infrastructure Rehabilitation	20.5	0.0	-19.8	0.7	0.0
Higher Education Sector Infrastructure Rehabilitation	32.7	0.0	-17.8	14.9	0.0
Law & Justice Sector Infrastructure Rehabilitation	3.5	0.0	-3.5	0.0	0.0
Strategic District Markets Infrastructure	0.7	0.0	-0.7	0.0	0.0
National Parliament Infrastructure Rehabilitation	5.1	0.0	-1.2	3.9	0.0
Outstanding PBSS (Police)	0.0	0.0	0.0	0.0	0.0
Transport Sector Infrastructure Rehabilitation	285.6	40.0	-44.8	280.8	0.0

Description	Opening Balance as at 1-Jan-2010 (2)	Debit (Receipt)	Credit (Payment)	Closing Balance as at 30-Sep-2010	Deposits Outstanding as at 30-Sep-2010
PNG Gas Development and Commitments	1.8	0.0	0.0	1.8	0.0
Resettlement of Rabaul Volcano Victims	9.9	0.0	-2.9	7.0	0.0
NBC Infrastructure Rehabilitation	0.0	0.0	0.0	0.0	0.0
Hospital and Healthcare Centre Rehabilitation	17.4	0.0	-2.1	15.3	0.0
Rehabilitation of Housing for Nurses	15.1	0.0	-3.8	11.3	0.0
Rehabilitation of Housing for Police	23.8	0.0	-8.8	15.0	0.0
Highlands Highway Rehabilitation	16.1	0.0	-16.1	0.0	0.0
District Services Improvement Program (1)	698.9	139.0	-391.5	446.4	0.0
Urbanization Pilots	0.0	0.0	0.0	0.0	0.0
Institutional Housing Pilot	19.1	0.0	-7.5	11.6	0.0
Housing Development Pilot	0.0	0.0	0.0	0.0	0.0
Cooperative Societies Establishment	0.1	0.0	-0.1	0.0	0.0
Madang Marine Park Development	8.5	0.0	-8.4	0.1	0.0
Rural Electrification	19.6	0.0	-19.0	0.6	0.0
Konebada Petroleum Park	50.0	0.0	-7.0	43.0	0.0
National Infrastructure Development (2)	125.1	0.0	-121.8	3.3	0.0
Land Reform Program	3.7	0.0	-3.5	0.2	0.0
National Border Authority	0.0	0.0	0.0	0.0	0.0
Regional, Provincial Treasury and District Admin. Offices	24.8	0.0	-9.5	15.3	0.0
Finance Commission of Enquiry	2.3	0.0	-1.1	1.2	0.0
Petroleum Outstanding MOA Commitments	0.0	0.0	0.0	0.0	0.0
LNG Project Development Cost	5.0	45.5	-18.8	31.7	0.0
National Stadium	0.0	0.0	0.0	0.0	0.0
Oro Restoration Authority	0.0	0.0	0.0	0.0	0.0
Waigani Office Development Project	0.0	0.0	0.0	0.0	0.0
Business Development Grants	0.0	47.0	0.0	47.0	0.0
Infrastructure Development Grants	0.0	0.0	0.0	0.0	0.0
Coastal Vessels Program	0.0	0.0	0.0	0.0	0.0
Fisheries Development Project	0.0	0.0	0.0	0.0	0.0
National Roads - Missing Links Trust Account	0.0	0.0	0.0	0.0	0.0
TOTAL	1,416.2	271.5	-736.6	951.1	0.0

Source: Department of Finance and Department of Treasury

1. DSIP Trust Account gives the sum of the amount in the main bank (BPNG) and the DSIP subsidiary bank accounts.
2. The opening balance of the National Infrastructure Development Trust Account has been revised down by K4.2 million since FBO to correct an oversight.

Deposits for the period 1 January to 30 September totaled K271.5 million (K231.5 million after excluding intra-trust transfer). This is comprised of K78.5 million of outstanding deposits from 2009, K40 million of inter-trust transfers from National Infrastructure Development Program to Transport Sector Infrastructure Rehabilitation, and K153 million paid from 2010 Budget.

The opening balance of Supplementary Budget Trust Accounts as at 1 January 2010 was K1,416.2 million and the closing balance of Supplementary Budget Trust Accounts as at 30 September 2010 was K951.1 million. Due to limited information on trust account expenditure, total expenditure for the period of 1 January to 30 September is derived by subtracting the opening balance and receipts from the closing balance.

Following is a summary of expenditure from Supplementary Budget Trust Accounts for the period 1 January to 30 September 2010:

- **K2.2 million was spent from the Agriculture Sector Development Program Trust Account** during this period. Due to the government decision to channel the 2009 and 2010 budget appropriations directly to the districts, this trust is no longer required and the Minister for Finance & Treasury has revoked the trust instrument and directed for the closure of the bank account.
- **K0.1 million was spent from the Airport Repairs and Upgrade Trust Account** for the repairs and upgrade of airport infrastructures around the country. This trust has been revoked and the related bank account closed due to all funds having been exhausted.
- **K24.6 million was spent from the Outstanding PBSS (Teachers) Trust Account** to fund the cost of Teacher's increment advancement. This trust has been revoked and the related bank account closed due to all funds having been exhausted.
- **K19.8 million was spent from the Education Sector Infrastructure Rehabilitation Trust Account** for infrastructure rehabilitation of schools around the country.
- **K17.8 million was spent from the Higher Education Sector Infrastructure Rehabilitation Trust Account** for the infrastructure maintenance of the four (4) government funded universities during this period.
- **K3.5 million was spent from the Law and Justice Sector Infrastructure Rehabilitation Trust Account** for the infrastructure rehabilitation of the law and justice sector facilities around the country. This trust has been revoked and the related bank account closed due to all funds having been exhausted.
- **K0.7 million was spent from the Strategic District Markets Trust Account** for construction of selected district markets around the country during this period. This trust has been revoked and the related bank account closed due to all funds having been exhausted.
- **K1.2 million was spent from the National Parliament Infrastructure Rehabilitation Trust Account** for the rehabilitation of the National Parliament House during this period.
- **K44.8 million was spent from the Transport Sector Infrastructure Rehabilitation Trust Account** for the selected priority road projects around the country during this period.
- **K2.9 million was spent from the Resettlement of Volcano Victims Trust Account** for the resettlement of the Rabaul Volcano victims during this period. The resettlement program is continuing and is headed by the East New Britain Provincial Government.
- **K2.1 million was spent from the Hospital & Health Care Rehabilitation Trust Account** for the Hospital & Health Care Centers infrastructure rehabilitation program during this period. The program is continuing, especially the Port Moresby General Hospital infrastructure rehabilitation program.
- **K3.8 million was spent from the Housing for Nurses Trust Account** for the Nurses housing project during this period. This project is continuing with the remaining funds in trust of K11.3 million.

- **K8.8 million was spent from the Rehabilitation of Housing for Police Trust Account** for the rehabilitation of the Police Housing around the country during this period. The Police Housing rehabilitation program is continuing with the remaining balance of K15.0 million as at 30 September 2010. This funding has been committed and is yet to be expended.
- **K16.1 million was spent from the Highlands Highway Rehabilitation Trust Account** for the highlands highway rehabilitation program during this period. Most of these expenditure occurred in the Simbu section of the highlands highway. The funds in this trust have been fully exhausted. However, the Department of Finance is still maintaining this trust anticipating additional funding for the highlands highway to be channeled through this trust.
- **K391.5 million was spent from the District Service Improvement Program Trust Account** for the district services improvement around the country during this period. The government has appropriated a total of K16.0 million per district under this program between 2006 to 2010. The Department of Finance does not have information on the impact of this program on the districts.
- **K7.5 million was spent from the Institutional Housing Pilot Trust Account** for the Public Service Housing Project during this period. This project is continuing with Department of Personnel Management yet to provide to the Department of Finance a detailed report on the progress of the Public Service Housing Project.
- **K0.1 million was spent from the Cooperative Societies Establishment Trust Account** for the cooperative societies establishments around the country during this period. Department of Commerce & Industry is yet to provide to the Department of Finance a detailed report on the progress of this program. Funds in this trust have been fully exhausted and the trust bank account is being closed.
- **K8.4 million was spent from the Madang Marine Park Trust Account** for the Madang Marine park development project during this period. The project is progressing well with additional funding from the China Export Import Bank.
- **K19.0 million was spent from the Rural Electrification Trust Account** for the government's rural electrification project during this period. Department of Petroleum & Energy is yet to provide to the Department of Finance a detailed report on the progress of this project.
- **K7.0 million was spent from the Konebada Petroleum Park Trust Account** for the development of the Konebada Petroleum Park during this period. Department of Petroleum and Energy is yet to provide to the Department of Finance a detailed report on the progress of this project.
- **K121.8 million was spent from the National Infrastructure Development Program Trust Account** for approved national road programs during this period. Funds were transferred to Works Department and expended for approved road projects accordingly.
- **K3.5 million was spent from the Land Reform Trust Account** for the land reform program during this period. Department of Lands and Physical Planning is yet to provide to the Department of Finance a detailed report on the progress of the land reform program. An audit is currently being carried out by the Department of Finance Internal Audit to ascertain the validity of certain expenditures which the Department of Finance considered are not in accordance with the purpose of the trust.

- **K9.5 million was spent from the Regional Treasury and District Administration Offices Establishment Trust Account** for the establishment of the Regional Treasury Offices in the four regions of Momase, Highlands, New Guinea Islands and Southern during this period.
- **K1.1 million was spent from the Finance Commission of Inquiry Trust Account** for the Commission of Inquiry into the Finance Department during this period. The Inquiry has ceased due to some legal issues and the report is yet to be made public.
- **K18.8 million was spent from the LNG Project Development Cost Trust Account** for the expenditures related to the PNG LNG project during this period. The funding available in this trust as at 30 September 2010 was K31.7 million which is yet to be expended.

5.5 DISTRICT SERVICE IMPROVEMENT PROGRAM TRUST ACCOUNTS

A total of K1,424.0 million, up to and including the 2010 Budget, has been appropriated for the District Service Improvement Program (DSIP). Of this amount, K356.0 million was appropriated in the 2006 Supplementary Budget, K534.0 million was appropriated in the 2007 Additional Supplementary Budget and K178.0 million was appropriated in each of the 2008 Supplementary Budget, the 2009 Development Budget and the 2010 Development Budget for priority expenditures within the 89 Districts.

For ease of management of these funds, an individual bank account was established for each of the 89 Districts, and to date a total of K1,337.0 million has been released into the 89 District DSIP Bank Accounts. The remaining K15.0 million in the Main Bank Account appropriated in the 2009 Budget and K44.0 million with National Planning department in the Development Budget appropriated in the 2010 Budget are in the process of being released into the 89 District Accounts. Extra funding is required to be sourced from elsewhere to finance the K28.0 million paid to the 14 Governors out of the DSIP Trust Account.

The opening balance as at 1 January 2010 of the 89 DSIP Trust Accounts was K479.9 million and the closing balance as at 30 September 2010 was K431.4 million. Total Receipts for the period 1 January to 30 September 2010 totaled K268.0 million. The Total Expenditure incurred for the period 1 January to 30 September 2010 totaled K316.4 million. Due to limited reporting, total expenditure is derived from the opening and closing balances and total receipts from the national government. Table 25 below shows the moments of funds in the DSIP subsidiary trust accounts.

For administrative ease of payment, the DSIP trust funds in some districts include receipts of funds from sources other than DSIP. The Department of Finance is unable to determine the magnitude of this non DSIP usage due to lack of provision of bank reconciliations from districts. Further, the Department of Finance is only aware of the amount it deposits into the DSIP subsidiary trust accounts. As a consequence, the DSIP payments may not accurately reflect expenditure on DSIP projects in all circumstances as it has been derived from the opening and closing balances and total receipts. This is highlighted by four of the districts (Bulolo, Namatanai, Sohe and Koroba-Lake Kapiago) recording a negative derived payments figure.

The Department of Finance, in consultation with the Department of National Planning and the Office of Rural Development, developed a Finance Instruction which provides guidance on the use and management of the DSIP funds. Monitoring of the implementation of the

DSIP Program is undertaken by the Office of Rural Development with the support of the respective 89 Districts.

Limited financial or project reporting has been provided by the implementing agencies including the relevant Districts to the Department of Finance to date.

Table 25: Movement of the 89 DSIP Bank Accounts from 1 January to 30 September 2010 (Kina)

District	Total Approp	Balance as at 1-Jan-10	Debits (Receipts)	Credits (Payments)	Balance as at 30-Sep-10
Abau	16,000,000	2,159,856	4,000,000	5,126,925	1,032,932
Goilala	16,000,000	268,261	4,000,000	4,110,844	157,417
Kairuku Hiri	16,000,000	2,001,194	3,000,000	1,759,295	3,241,900
Rigo	16,000,000	6,588,570	3,000,000	8,921,515	667,055
Gazelle	16,000,000	4,707,566	3,000,000	1,067,165	6,640,401
Kokopo	16,000,000	3,192,727	3,000,000	3,850,634	2,342,093
Pomio	16,000,000	5,078,501	3,000,000	3,876,363	4,202,139
Rabaul	16,000,000	8,643,684	3,000,000	5,234,039	6,409,645
Ambunti-Drekikir	16,000,000	1,472,932	4,000,000	3,523,195	1,949,737
Angoram	16,000,000	9,628,855	2,000,000	6,256,716	5,372,139
Maprik	16,000,000	11,182,266	3,000,000	4,260,530	9,921,736
Wewak	16,000,000	2,870,660	1,000,000	3,107,535	763,126
Wosera-Gawi	16,000,000	9,631,746	3,000,000	4,959,851	7,671,895
Yangogoru-Saussia	16,000,000	9,942,256	3,000,000	5,246,730	7,695,526
Daulo	16,000,000	8,780,241	3,000,000	5,758,649	6,021,592
Goroka	16,000,000	7,876,292	3,000,000	7,874,194	3,002,098
Henganofi	16,000,000	6,648,863	3,000,000	4,999,401	4,649,462
Kainantu	16,000,000	6,678,044	3,000,000	4,022,826	5,655,218
Lufa	16,000,000	5,158,987	3,000,000	2,027,852	6,131,134
Obura-Wanenara	16,000,000	5,421,084	3,000,000	5,499,693	2,921,390
Okapa	16,000,000	2,897,755	3,000,000	1,855,117	4,042,638
Unggai-Bena	16,000,000	6,533,366	3,000,000	3,736,699	5,796,667
Kandep	16,000,000	544,561	2,000,000	1,144,040	1,400,521
Kompiani-Ambun	16,000,000	4,263,238	3,000,000	6,447,463	815,775
Lagaip-Porgera	16,000,000	18,965,718	3,000,000	17,365,188	4,600,530
Wabag	16,000,000	1,673,438	3,000,000	1,074,633	3,598,804
Wapenamanda	16,000,000	5,238,485	3,000,000	7,076,995	1,161,490
Kerema	16,000,000	1,157,492	3,000,000	2,596,636	1,560,856
Kikori	16,000,000	134,978	3,000,000	3,103,704	31,274
Bogia	16,000,000	9,269,786	3,000,000	644,503	11,625,282
Madang	16,000,000	7,896,190	3,000,000	152,851	10,743,339
Middle Ramu	16,000,000	6,785,919	3,000,000	2,786,399	6,999,521
Raikos	16,000,000	9,877,841	3,000,000	216,305	12,661,536
Sumkar	16,000,000	3,356,729	3,000,000	2,636,966	3,719,763
Usino-Bundi	16,000,000	7,100,197	3,000,000	2,296,898	7,803,299
Manus	16,000,000	5,233,053	3,000,000	1,137,411	7,095,642

2011 Budget, Volume 1

District	Total Approp	Balance as at 1-Jan-10	Debits (Receipts)	Credits (Payments)	Balance as at 30-Sep-10
Alotau / Rabaraba	16,000,000	5,694,345	3,000,000	6,660,685	2,033,660
Esa'ala	16,000,000	7,512,193	1,000,000	2,857,382	5,654,811
Kiriwina	16,000,000	8,675,600	3,000,000	4,138,835	7,536,765
Samarai Murua	16,000,000	3,898,083	3,000,000	3,866,910	3,031,173
Bulolo	16,000,000	648,157	3,000,000	(17,250)	3,665,407
Finschaffien	16,000,000	7,189,724	3,000,000	3,996,759	6,192,965
Huon Gulf	16,000,000	5,520,378	3,000,000	3,691,674	4,828,703
Kabwum	16,000,000	7,037,357	3,000,000	3,307,486	6,729,872
Lae	16,000,000	2,218,909	3,000,000	1,862,586	3,356,323
Markham	16,000,000	7,004,728	3,000,000	3,223,130	6,781,597
Menyamyia	16,000,000	5,258,197	3,000,000	2,361,202	5,896,995
Nawaeb	16,000,000	2,967,701	3,000,000	4,278,461	1,689,240
Tewa-Siasi	16,000,000	4,682,119	3,000,000	1,635,061	6,047,058
Moresby North	16,000,000	7,689,285	3,000,000	4,847,081	5,842,204
Moresby North West	16,000,000	10,820,392	3,000,000	3,160,115	10,660,277
Moresby South	16,000,000	6,788,684	3,000,000	950,202	8,838,482
Kavieng	16,000,000	4,096,870	3,000,000	4,149,559	2,947,311
Namatanai	16,000,000	4,661,560	3,000,000	(93,888)	7,755,447
Central Bougainville	16,000,000	9,925,377	3,000,000	5,878,391	7,046,986
North Bougainville	16,000,000	2,300,829	3,000,000	5,219,382	81,447
South Bougainville	16,000,000	1,084,984	4,000,000	2,993,972	2,091,012
Ijivitari	16,000,000	4,980,296	3,000,000	4,729,282	3,251,014
Sohe	16,000,000	4,857,404	3,000,000	(1,378,985)	9,236,389
Aitape-Lumi	16,000,000	4,559,115	2,000,000	2,514,473	4,044,642
Nuku	16,000,000	2,849,567	3,000,000	5,307,290	542,276
Telefomin	16,000,000	8,485,989	5,000,000	5,184,655	8,301,334
Vanimo-Green	16,000,000	4,258,558	3,000,000	4,004,029	3,254,529
Chuave	16,000,000	4,927,764	3,000,000	4,287,710	3,640,055
Gumine	16,000,000	4,356,200	3,000,000	4,482,576	2,873,624
Karamui-Nomane	16,000,000	7,300,066	3,000,000	8,319,084	1,980,982
Kerowagi	16,000,000	3,613,904	3,000,000	4,767,667	1,846,238
Kundiawa-Gembogl	16,000,000	4,542,299	3,000,000	6,600,697	941,602
Sinasina- Yongumugl	16,000,000	5,100,425	3,000,000	198,151	7,902,274
Ialibu-Pangia	16,000,000	4,551,640	3,000,000	3,244,993	4,306,647
Imbongu	16,000,000	3,743,762	4,000,000	4,474,842	3,268,919
Kagua-Erave	16,000,000	41,578	3,000,000	3,010,421	31,157
Komo-Magarima	16,000,000	4,022,635	3,000,000	2,591,187	4,431,448
Koroba-L/Kopiago	16,000,000	3,580,705	3,000,000	(1,350,425)	7,931,130
Mendi	16,000,000	2,244,450	5,000,000	6,088,917	1,155,533
Nipa-Kutubu	16,000,000	4,018,277	1,000,000	2,421,423	2,596,854
Tari-Pori	16,000,000	152,018	3,000,000	2,777,950	374,067

2011 Budget, Volume 1

District	Total Approp	Balance as at 1-Jan-10	Debits (Receipts)	Credits (Payments)	Balance as at 30-Sep-10
Kandrian	16,000,000	8,420,388	3,000,000	5,644,424	5,775,963
Talasea	16,000,000	6,631,214	3,000,000	1,365,230	8,265,984
Middle Fly	16,000,000	11,219,447	3,000,000	107,730	14,111,717
North Fly	16,000,000	6,879,618	3,000,000	320,530	9,559,088
South Fly	16,000,000	6,046,791	3,000,000	2,608,452	6,438,340
Dei	16,000,000	5,073,759	3,000,000	3,830,255	4,243,504
Hagen	16,000,000	10,543,492	3,000,000	2,016,416	11,527,076
Jimi	16,000,000	2,586,325	3,000,000	3,414,601	2,171,725
Mul/Bayer	16,000,000	6,411,939	4,000,000	2,610,031	7,801,908
North Waghi	16,000,000	5,390,779	3,000,000	2,270,454	6,120,326
South Waghi	16,000,000	653,567	3,000,000	1,680,867	1,972,700
Tambul-Nebiler	16,000,000	3,287,464	3,000,000	3,553,930	2,733,535
Total	1,424,000,000	479,868,236	268,000,000	316,422,353	431,445,883

Source: Department of Finance

CHAPTER 6. TAXATION MEASURES

6.1 OVERVIEW

The 2011 Budget introduces a number of taxation policy measures. The Government will undertake a further but modest Tariff Reduction Program (TRP), with the aim of promoting an internationally competitive and efficient private sector, and update housing tax concessions which have been substantially eroded over time by house price inflation.

The Government will also seek to improve environmental and social outcomes by allowing tax deductions for environmental protection and clean-up costs, and reduce the alcohol content of beverages which receive concessional excise treatment.

Other taxation measures will enhance Retirement Savings Accounts and seek to improve compliance in the remittance of salary and wages taxes.

There are also a number of minor policy and technical amendments to clarify the law and administrative procedures, strengthen enforcement activities, increase administrative efficiency and correct technical errors.

There are no new taxes introduced in this budget.

6.2 TARIFF REDUCTION PROGRAM

The 2011 Budget introduces a modest TRP that will be implemented over seven years starting in 2012. The TRP is consistent with the 2007 Tariff Review, which found that tariff reduction from 1999-2006 had delivered significant benefits to PNG, and recommended further tariff reductions.

Items in the prohibitive and protective tariff rates will be gradually lowered in three year intervals until they are more closely aligned with the intermediate rate of 15.0 per cent. The intermediate rate on goods produced in PNG will remain unchanged. Overall, this will achieve lower and more uniform effective rates of protection.

However, tariffs on selected agricultural goods produced extensively in rural PNG such as fresh produce, fruits and vegetables will remain at their current rate. In addition, the non-ad valorem tariffs on alcoholic beverages and tobacco will not be reduced in order to help support better health outcomes.

A key objective of the TRP is to encourage the development of more efficient and internationally competitive industries that maximise PNG's comparative advantages. The TRP will reduce input costs for many businesses, reduce the costs of development activities in PNG, and reduce the price of consumer goods. The TRP will make PNG's exports more competitive on world markets and boost growth in export industries.

Table 26: Tariff Reduction Program: 2012- 2018

Category	Old and Existing Rates				New Rates		
	1999-2000	2001-2002	2003-2005	2006	2012-2014	2015-2017	2018
Intermediate Rate	30%	25%	20%	15%	15%	15%	15%
Protective Rate	40%	35%	30%	25%	20%	15%	15%
Prohibitive Rate	55%	50%	45%	40%	35%	30%	25%
Selected Agricultural Items							
Protective Rates ¹	40%	35%	30%	25%	25%	25%	25%
Prohibitive Rates ²	55%	50%	45%	40%	40%	40%	40%

Source: Department of Treasury and PNG Customs

1. Includes coffee and tea, vanilla, cardamom, ground nuts and copra, coconut and honey.

2. Includes a range of fresh fruits and vegetables (including but not limited to tomatoes, onions, lettuce, carrots, potatoes, taros and yams, eggplant, bananas, watermelon, pineapples, citrus fruits and avodados) and cashew nuts.

At the same time as reducing tariffs, the Government is investing substantially in key infrastructure projects, education and law and order, to address some of the business impediments and skill shortages that confront business over the medium term.

The TRP is estimated to reduce revenue in 2012 by K10.0 million.

6.3 HOUSING TAX CONCESSIONS

The Government will update a number of thresholds relating to housing tax concessions to better reflect housing market conditions. The net effect of these amendments is an estimated increase in revenue of K8.0 million in 2011.

6.3.1 Employer Assistance to Purchase a First Home

The limit on the cost of housing will be increased from K75,000 to K400,000 for repayable amounts provided by an employer to an employee to purchase their first home. This threshold better reflects current market conditions.

Furthermore, the “low cost housing scheme” for a subsidy provided by an employer to an employee to purchase a first home will be renamed “employee first home buyer scheme” to better reflect the current operation of the scheme.

6.3.2 Increase Housing Thresholds and Benefits

The *Income Tax Act 1959* provides highly concessional taxation treatment for employer provided housing. Employees are not taxed on the value of the housing provided, but are instead taxed on the prescribed benefits contained in the Income Tax Regulations. The prescribed benefits were last updated in 2003, and since that time, the cost of housing has appreciated substantially.

Over the past 7 years, the substantial appreciation of housing costs has had two key effects on this concession.

- It has provided a large and growing tax subsidy to employees who receive free housing from their employer, but particularly to high income employees. For example, the implicit tax subsidy for a high income earner in employer-provided housing that rents for K5,000 per week is over K100,000 per annum.

- Modest accommodation previously assessed to be “low cost” or “medium cost” is now assessed as “high cost” in many cases. Hence low and middle income earners are taxed on the same housing benefits as high income individuals living in expensive housing.

To address these issues, the Government will update the prescribed thresholds and benefits to better reflect current market conditions. The amendment seeks to strike a better balance between encouraging and supporting employers who provide accommodation to employees, and ensuring fairness for all taxpayers, including those who do not benefit from employer provided housing. It also restores equity between employees living in high cost, medium cost and low cost housing.

While the increase in taxable benefits is highest for individuals living in employer-provided housing with a market value in excess of K800,000, these individuals will still pay an effective rate of tax of less than 5 per cent of the underlying value of housing benefits, which compares favourably with marginal income tax rates. The measure will apply from 1 January 2011 and is estimated to increase tax revenue by K10.0 million in 2011.

Table 27: Prescribed Housing Thresholds

	Current thresholds 2003-2010	New thresholds from 2011
Low cost housing	Market value of up to K95,000 (or rent up to K300 per week)	Market value of up to K400,000 (or rent up to K1,000 per week)
Medium cost housing	Market value of between K95,000 and K220,000 (or rent between K300 and K950 per week)	Market value of between K400,000 and K800,000 (or rent between K1,000 and K3,000 per week)
High cost housing	Market value of over K220,000 (or rent of K950 per week or above)	Market value of over K800,000 (or rent of K3,000 per week or above)

Source: Income Tax Act 1959 and Department of Treasury

6.3.3 Increase Stamp Duty Exemption Threshold for First Home Buyers

The stamp duty exemption threshold for first home buyers will be increased from K210,000 to K500,000 from 1 January 2011. The current threshold was last updated in 2003 and has fallen behind the substantial increase in the cost of housing. The stamp duty calculation will also be simplified for a first home purchase by applying a uniform rate of stamp duty of 5% on the amount of the purchase price in excess of K500,000.

This measure will assist many people to buy their first home. Changes to this tax exemption are estimated to reduce revenue by K2.0 million in 2011.

6.4 ENVIRONMENTAL AND SOCIAL TAX MEASURES

The Government will introduce two tax measures that seek to improve environmental and social outcomes in PNG.

6.4.1 Environmental Expense Tax Deductions

The Government will clarify the *Income Tax Act 1959* to allow environmental protection and cleanup costs as a specific tax deduction from 1 January 2011. This measure will support and encourage companies to safeguard the environment in their pursuit of income earning

activities. The amendment will remove uncertainty about the tax deductibility of environmental expenditure which occurs “before” or “after” the income producing activity.

6.4.2 Reduction in Alcohol Content of Concessional Excise

The Government provides a concessional rate of excise for alcoholic beverages made from fruit grown in PNG. The concession is being used to produce high alcohol beverages that are inexpensive, which is contributing to anti-social behaviour and adverse health effects. The concession is also eroding the Government’s excise revenue base.

To address these concerns, the Government will limit the alcohol content of beverages that benefit from the concessional rate of excise to 10 per cent by volume, from 1 January 2011. Currently, there is no limit of the alcohol content of this excise item.

The Government will also clarify that the concession only applies to fruit grown and fermented in PNG, and not to beverages made from imported alcohol. This is consistent with the original policy intent of the concession.

6.5 ENHANCEMENT OF TAX COMPLIANCE FOR SALARY AND WAGES TAX

A penalty will be introduced from 1 January 2011 on directors of private companies who fail to act on notices from the Internal Revenue Commission (IRC) on the company’s non-remittance of salary and wages tax. This measure will not apply to directors by virtue of a Government position, directors appointed by NEC, or directors not in a position to direct the company.

This amendment is intended to address a large and growing pool of unpaid salary or wages tax by some companies. The amendment is also intended to promote competitive neutrality by ensuring companies do not gain an unfair advantage over other companies by not complying with their salary and wage tax obligations.

6.6 ENHANCEMENT OF RETIREMENT SAVINGS ACCOUNTS

The maximum balance for Retirement Savings Accounts (RSAs) will be increased from K100,000 to K250,000 from 1 January 2011. The amendment better reflects retirement lump sum payouts, which have increased substantially in recent years owing to high superannuation fund returns, higher wages and higher employment.

In addition, withdrawals from RSAs in excess of the prescribed limit will no longer result in the loss of the tax exemption on investment earnings. The current treatment can result in disproportionately large penalties for small breaches of the limits. Excess withdrawals will continue to be taxed at a uniform rate of 30.0 per cent.

6.7 MINOR POLICY AND TECHNICAL AMENDMENTS

A number of minor policy and technical amendments will be introduced from 1 January 2011 to clarify the law and administrative procedures, strengthen enforcement activities, increase administrative efficiency and correct technical errors.

The *Income Tax Act 1959* will be amended to:

- enable service of court proceedings on corporate taxpayers without the need to conduct company searches at the Investment Promotion Authority;

- expressly provide for the Commissioner General of the Internal Revenue Commission to have general administrative power of the Income Tax Act;
- allow the sharing of tax information amongst certain law enforcement agencies;
- clarify the procedure for resource operations to make an election to pool allowable exploration expenses under section 155N; and
- correct a minor technical error to Section 159A(4) by replacing 'gas' with 'resource' and update section 241 by replacing the reference to 'High Commissioner' with 'Minister'.

The Goods and Services Tax Act 2003 will be amended to include in the definition of 'Resource Company' companies who hold a mining lease, to provide access to GST zero-rating.

The *Customs Tariff Act 1990* will be amended to clarify the import duty exemption provided to the PNG LNG project during the construction phase, to ensure the law works as intended.

6.8 AREAS OF POLICY DEVELOPMENT IN 2011

The following represent areas of policy development that will be considered in 2011, for which the Government wishes to provide notice to industry or seek industry comment. Industry and other interested groups are invited to lodge submissions on these issues by 30 April 2011, as part of the regular process for making Pre-Budget submissions.

Export Subsidy Program

PNG's Export Subsidy Program is scheduled to be abolished as of 31 December 2015, regardless of the date of first export sales, to be consistent with PNG's obligations under the World Trade Organisation.

Taxation of unit property trusts

The Government will consider amendments to the taxation of unit trusts to remove barriers to participation by superannuation entities.

This may assist to create new property unit trusts, thereby deepening investment markets in PNG, providing greater scope for property investors to diversify risk and improving access to property investment for smaller investors. This may also contribute to larger developments on existing parcels of land.

The Government will consult on the feasibility and potential design of a proposal and the attractiveness for local entities. This includes the mechanism to ensure that superannuation entities are subject to similar rates of tax when investing in property directly and when investing through unit trusts.

Taxation refunds

The Government will move to discontinue the current practice of limiting income tax refunds by annual appropriation. This practice can result in delays in the payment of tax refunds, which is inconsistent with the Government's objective of encouraging voluntary compliance

with the tax laws and ensuring fairness for taxpayers. This will involve changes to the administrative practices of the Internal Revenue Commission.

Payment of mining and petroleum tax instalments

The Government will investigate the extent of underpayment of mining and petroleum tax instalments by mining and petroleum companies through the year. The Government will consider introducing a penalty regime to discourage the significant underestimation of mining and petroleum taxation instalments.

Highlands Highway Special Tax Credit

The Government will consider reinstating a Special Tax Credit rate for repairs to the Highlands Highway for a period of time, while seeking to avoid any abuse of the concession.

Nil assessments

In considering a technical amendment to recognize nil assessments in the definition of assessment, the Government will look to introduce a longer period of time for IRC to review returns with a nil assessment (compared to returns with a positive assessment).

CHAPTER 7. BUILDING THE ECONOMY THROUGH SUSTAINED REFORMS

7.1 OVERVIEW

Papua New Guinea continues to benefit from past reform. These reforms have contributed to sustained economic growth that shielded the economy from the worse effects of the recent global financial crisis and has provided a conducive environment for investment as seen with the PNG LNG project.

The Government will ensure that development policies and strategies, including existing and any new reforms in 2011, will be closely aligned with key objectives of the Vision 2050 and the Papua New Guinea Development Strategic Plan 2010 - 2030 (DSP) and Medium Term Development Plan (MTDP). This will require a clear and consistent commitment by the Government to address the underlying issues that affect service delivery and impede private sector investment and growth.

In 2011, the Government will demonstrate its commitment to public sector reform by exploring opportunities to improve service delivery and continuing with the existing public sector reform initiatives to improve the efficiency, effectiveness and affordability of the public sector. The Government will also continue with its longstanding Public Expenditure Review and Rationalization (PERR) program.

The Government supports the development of a competitive and dynamic private sector that underpins economic growth. In recent years, the Government has undertaken various initiatives in this regard to promote and provide a conducive environment for businesses to invest and generate growth. In 2011, the Government will monitor existing reforms to ensure they achieve their objectives and explore areas for further reform. In order to provide a stable investment climate that promotes a competitive and dynamic private sector, the Government will continue to remove impediments to doing business and investment in PNG.

7.2 PUBLIC SECTOR REFORM

7.2.1 The Papua New Guinea Vision 2050

In November 2009, the Government launched its vision for Papua New Guinea – the Papua New Guinea Vision 2050 (PNG Vision 2050) for the next forty years. The PNG Vision 2050 is a fundamental policy reform initiative that charts the development path for Papua New Guinea over the next forty years by setting key Strategic Policy Directions and Outcomes. The Prime Minister during the launching of PNG Vision 2050 titled “The Next Generation of Nation Builder” stated;

"We have only one Strategic Vision and that is the Papua New Guinea Vision 2050. All future medium to long-term plans must align to this vision in a cascading way, whereby there is only one higher vision. Others simply take their cue from the Papua New Guinea Vision 2050".

The PNG Vision 2050 is underpinned by seven pillars which will be the foundation on which development plans from 2011– 2050 will be anchored.

The seven Pillar Strategic Focus Areas are:

- Human Capital Development, Gender, Youth and People Empowerment;
- Wealth Creation;
- Institutional Development and Service Delivery;
- Security and International Relations;
- Environment Sustainability and Climate Change;
- Spiritual, Cultural and Community Development; and
- Strategic Planning, Integration and Control.

A total of 254 Strategic Policy Directions and 278 Expected Policy Outcomes, have been developed to form the basis for wider consultations with all the seven Pillar agencies to provide the operational policy framework for the alignment by all sectors.

The PNG Vision 2050 is one of three major policy initiatives of the Government to significantly improve access and quality of life for all Papua New Guineans. The PNG Vision 2050 will be developed under the current three tier political and administrative structures of Government and delivered through an integrated service delivery mechanism model. A Vision 2050 Development Centre has been established in the Department of the Prime Minister and NEC to operationalize and ensure the implementation of the PNG Vision 2050.

Securing the country's districts over the next 10 years through the first two Medium Term Development Plans (MTDP) through the provisions of enabling environment in clean water supply, communications, transport, security, health, education, electricity, office facilities and postal services, banking, commercial services and fire services are all vital for implementing PNG Vision 2050. Further detail on the first of these MTDP's for 2011 – 2015 is at Chapter 8.

7.2.1.1 The Vision and Mission

The PNG Vision 2050 seeks to achieve a Smart, Wise, Fair, Healthy and Happy Papua New Guinea by 2050.

- Being 'smart' means to encourage and reward excellence, innovation and relevance.
- Being 'wise' means our people, our institutions and our systems will practice and uphold transparency, accountability and good governance. Our leaders and people will consistently make the right decisions.
- Being 'fair' means our people; our institutions and our systems will equitably distribute resources and opportunities.
- Being 'healthy' means our people are spiritually, physically and culturally fit with a sound mind for societal living.
- Being 'happy' means our people will be healthy, wealthy and safe.

The PNG Vision 2050 mission is for PNG to be ranked in the top 50 countries in the United Nations Human Development Index by 2050, creating opportunities for personal and national advancement through economic growth, smart innovative ideas; quality service and ensuring a fair and equitable distribution of benefits in a safe and secure environment for all citizens.

This will require dedication, commitment and hard work by all public officials in all agencies and in the three levels of Government, including the village people in rural areas to achieve this mission. PNG is currently ranked at 148 out of 187 countries.

7.2.1.2 Immediate Priorities

Immediate concerns rest on service delivery with particular emphasis on infrastructure, human capital development and wealth creation. The PNG Vision 2050 Development Centre will work closely with Government Agencies, Provincial Administrations, Civil Society and Development Partners in implementing the PNG Vision 2050.

All Government Agencies and Provincial Administrations will be required to develop and align their 10 year Development Plans with the DSP and the PNG Vision 2050.

7.2.1.3 Delivery of the PNG Vision 2050

The PNG Vision 2050 will be implemented through an integrated approach involving the rationalization of the policy, planning, implementation and resourcing structures, systems and processes of delivery, support to enable the Districts to function effectively and grant support to communities to participate in economic development. The integrated approach supports a “top down policy” and “bottom-up planning” method and where the people’s needs would be identified at the Ward levels cascading up-wards to the Local Level Governments then to Districts and to the Provincial level. Prioritization of all Wards and LLG needs would be done at the District Levels. The Integrated Provincial Development Plan (IPDP) would support this process at the provincial level.

7.2.1.4 Provincial and Local Level Service Monitoring Authority

The Provincial and Local Level Service Monitoring Authority (PLLSMA) has been mandated to coordinate and monitor national policies at the provincial and local level with the ultimate goal of improving service delivery. This coordination role is supported by the establishment of the Provincial Coordination Monitoring Committees (PCMC) in each of the provinces, which will support the monitoring of and reporting on the implementation of the PNG Vision 2050.

7.2.1.5 Reporting on the implementation of the PNG Vision 2050

In terms of reporting, the Government intends to formulate a Government Performance Result Act legislation which will provide annual briefs to the Prime Minister on the implementation of the PNG Vision 2050. This report will form the basis for the Prime Minister’s State of the Nation Address on an annual basis.

A Whole of Government (WOG) Policy Performance Framework is been developed to provide a consistent template for monitoring the progress in implementation and performance of the PNG Vision 2050. Annual reports from departments and agencies and provincial administrations will provide progressive status of overall performance of service delivery in the country.

7.2.2 The Public Expenditure Review and Rationalization Program

Public sector reforms continue to be pursued through the longstanding Public Expenditure Review and Rationalization (PERR) program, which will continue in 2011. From the nine projects under the PERR program, the projects 1 and 2 are progressing well in achieving the PERR objectives of fiscal sustainability and restoring the integrity of the budget institutions and systems, respectively. The implementation of both projects is now embedded as a

routine part of the work undertaken by the Department of Treasury. The sections below will highlight the updates on project 3 through to project 9.

7.2.2.1 Civil Service Size and Payroll Reform

The progress of PERR projects relating to civil service size and payroll (projects 3 and 4) require more work and closer monitoring particularly on securing the payroll system to eliminate waste, leakages and fraud in salary administration and reduce spending on salaries within National and Provincial Governments.

In terms of Government payroll, most national departments and agencies are all connected to the centralized Government Human Resource (HR) Concept Payroll System. The challenge now is for departments and agencies operating in provinces and districts to have access to the HR payroll system to manage their own payroll data and monitoring. A pilot project has been rolled out to connect remote hospital sites in Mendi, Mt Hagen and Port Moresby General Hospitals to the payroll system.

Department of Personnel Management (DPM) audits have revealed large discrepancies in the management of human resource. Four regional and national department workshops were conducted in mid-2010 to review the manpower, establishment and payroll of the Public Service of PNG for the better management of public service workforce. Under the workforce planning exercise, agencies have been tasked to identify and submit names of their officers who meet the age criteria for retirement to the Secretary of DPM for deliberation by the Redundancy Monitoring Committee.

7.2.2.2 Improving Financial Management and Control

There continues to be satisfactory progress made in PERR Projects 5, 6 and 8 that are managed and implemented by the Department of Finance.

As part of the activities under project 5 and to improve financial management and control, all Financial Controller positions have been filled in the major spending government departments. In addition new Audit Committees continue to be established in national departments and provincial governments to review internal control systems.

In relation to project 6, the implementation of the Integrated Financial Management System (IFMS) has provided the functionality for setting ceilings, preparation of the recurrent and development estimates, budget reviews and approval, execution and maintenance. The Department of Treasury completed the preparation of 2011 Budget ceilings using the IFMS for the pilot agencies – Treasury, Planning and Finance. All recurrent Budget preparation modules and Accounting modules have been completed. The IFMS contains all information in the 2010 Budget documents and it will be the General Ledger for the Government in 2011.

And in relation to project 8 on improving non-tax revenue management, all submissions on review of fees and charges will now be managed by each line department with assistance from the Department of Finance. The current revenue reporting and receipting processes are continuing with official government receipts regularly ordered and delivered to cash offices, Provincial Treasuries and line departments. Internal record keeping has also been improved with the setting up of database of provincial collections. The EFTPOS Merchant Facility was successfully installed at the Vulupindi cash office in May 2010 and deployed in PGAS to account for all transactions done through the EFTPOS transactions.

7.2.2.3 Rightsizing Initiative

As part of the activities under project 7 of the PERR program, the greatest concern remains the growing cost of the public sector and the need to improve service delivery and achieve cost savings. In recognition of the importance of this, the Government tasked the Department of Prime Minister & NEC, through the Public Sector Reform Management Unit (now re-named the PNG VISION 2050 Development Centre) with support from the Department of Treasury, to re-examine the 2006 Public Sector Rightsizing Initiative with a plan outlining major restructuring across the Public Service. Following consultations between the Department of Prime Minister & NEC and the Department of Treasury, a two phased approach to implement the recommendations of the Rightsizing Report was agreed upon. This will comprise Immediate Actions (2010-2011) and Medium Term Actions (2012-2015). Immediate actions focus on retaining the current structures but undertaking major internal rationalization and streamlining to get all Departments and Agencies revert to performing their core functions. This strategy recognises that significant savings can be identified through this process as there is a lot of duplications and wastage in current Government structures.

Under Medium Term Actions (2012-2015) work plans for major structural changes will be implemented. This will include the implementation of the recommendations of the Rightsizing Report. This report made critical recommendations for changes to the Public Service and included the need to abolish and merge certain Departments and Agencies. Work plans will be prepared and submissions made to secure the views and decisions of the National Executive Council on the way forward to implement major structural changes in the Public Service. The Rightsizing Report also proposed options to out-source, privatize and devolve certain Government functions. Some of these options have not been fully utilized. This will be looked at critically as a way forward.

7.2.2.4 Improving the Governance of Statutory Authorities

The Government has delegated Statutory Authorities the responsibilities to perform their respective governmental functions through the provision of public goods and services. The rationale is to establish Statutory Authorities to achieve greater independence from the Government and increase efficiency.

To ensure this mechanism is effective, project 9 has undertaken some reviews with technical assistance from donor agencies especially the ADB. The ADB report provided several recommendations including proposed amendments to the *Public Finances (Management) Act 1995* (PFMA). The key recommendation is for the current accountability regime to be strengthened by enhancing the enforcement provisions contained in Part VIII of the PFMA, and introducing an Annual Performance Agreement (APA) to improve the accountability of Statutory Authorities to the Government.

In 2011, work will be done on the ten selected Statutory Authorities who are invited to participate in a pilot program to trial the recommendations. If proved successful there will be a roll out to other Statutory Authorities in 2012. After completion of the piloted program, a policy submission and draft amendments to the PRMA will be submitted to the NEC for approval and the key recommendations will be implemented by 2012.

7.2.3 Equitable Resource Allocations to Provincial Governments

The reforms to the Organic Law on Provincial Governments and Local Level Governments and the *Intergovernmental Relations (Functions and Funding) Act 2009* have changed the

system of intergovernmental financing since 2009. These changes will equalize the system of provincial and local-level government funding, and focus on meeting the costs of basic service delivery.

Under this new system, the total goods and services grants for distribution (called the equalization amount) depends on a set proportion of the total 'core' tax revenue which excludes variable mining and petroleum revenues available to the National Government each year. Whilst the percentage is set, the equalization amount can go up or down depending on the state of the economy. The equalization amount is then distributed based on how much it costs to deliver a basic level set of service against the total revenues available to each provincial government yearly. This new system is and will remain affordable.

The equalization amount for 2011 is K250.0 million, an increase of K42.7 million from 2010. This was arrived at by applying the prescribed percentage for 2010 of 5.84 per cent to the 2009 actual net national revenue amount of K4,281.5 million. Of the K250.0 million, K112.6 million is to be distributed amongst provinces and LLGs based on need while K137.4 million is to meet the transitional guarantee.

Additional funding will be distributed on need basis and will phase in over the five year transitional period of this new system. Once the system is fully implemented after 2013, all provinces should have financial capacity to meet at least 70.0 per cent of their basic service delivery needs.

7.2.4 District Treasury Roll-out Program

Since its inception in 2004, to date, 61 District Treasuries have been fully commissioned and made functional. The remaining 25 District Treasuries are planned to be opened in 2011. The Government is committed and will continue to make funds available to fully fund the District Treasury Rollout Program in 2011.

The Government has also established Cash Offices in the districts where mineral exploitation is taking place. There are three Cash Offices being built in, Geimbogl District in Chimbu Province, Porgera District in Enga Province and Komo District in the Southern Highlands Province.

Major services which will be established in 2011 include:

- (a) Establishment of Finance Regional Office (Chimbu – Highlands Region, Madang – Momase Region, Rabaul – New Guinea Islands Region and Central- Southern Region),
- (b) Installation of VSaTs in all the District Treasury Offices to improve communication; and
- (c) Arrangement for the coordination and management of BSP Bank Agencies in the District Treasuries by BSP Limited.

7.2.5 PNG's Second Trade Policy Review

The World Trade Organization (WTO) conducted its second Trade Policy Review (TPR) for Papua New Guinea this year. The WTO conducts TPRs to ensure greater transparency among the WTO members by providing information about the national trade policies, laws and regulations of its members.

The 2010 review noted that over the last ten (10) years, Papua New Guinea has embarked on major structural reforms and policy development and adjustments in the different sectors of the economy to enhance economic growth.

Although, Papua New Guinea does not have a Trade Policy, the growth and expansion of trade has been pursued and implemented through the various sectoral policies.

Papua New Guinea has pursued its trade policy through its membership in the WTO, Asia Pacific Economic Cooperation (APEC), Melanesian Spearhead Group Trade Agreement (MSGTA), Pacific Island Countries Trade Agreement (PICTA), and the Interim Economic Partnership Agreement (iEPA). Papua New Guinea is also in the process of negotiating the Pacific Agreement on Closer Economic Relations (PACER) with Australia and New Zealand (ANZ).

Given the importance of trade to the economy, the 2010 review has reinforced the need for the formulation of a comprehensive trade policy to ensure that Papua New Guinea reduces its excessive reliance on mining and petroleum resources and to utilise international trade for economic growth and development.

It is planned that work will commence on the development of this policy in 2011 by the Department of Foreign Affairs and Trade with the assistance from the European Union (EU) under the Trade Related Assistance Programme (TRAP).

7.3 A COMPETITIVE AND DYNAMIC PRIVATE SECTOR

The development of a competitive and dynamic private sector is important because it creates employment, generates incomes and stimulates economic growth. Promoting and supporting the growth of the private sector in providing a conducive environment for businesses to invest and grow remains a key priority of Government.

7.3.1 Enhancing Competition and Economic Regulation

The Government remains committed to promoting a competitive and dynamic private sector because of the positive impact this has on the economy through increasing efficiency, productivity and innovation while lowering prices and improving the quality of service delivery. In 2011, the Government will build on the benefits of previous reforms, with a focus on telecommunications and electricity, and will continue to provide sound economic regulation via the Independent Competition and Consumer Commission (ICCC).

7.3.1.1 Telecommunications (ICT)

Given the success of enhanced competition in the mobile telecommunications sector, the Government has moved to develop full competition in the ICT sector through the establishment of a new industry-specific regulator, the National Information and Communications Authority (NICTA). The NICTA will replace the technical regulatory functions of the Papua New Guinea Radio Communications and Telecommunications Technical Authority (PANGTEL) and will be equipped with all powers and functions needed to effectively regulate the PNG ICT sector. It will also take on the ICT related regulatory pricing functions of the ICCC whilst leaving the competition regulatory functions within the ICT sector to the ICCC.

Regulations are currently being finalized by the Government to support the *NICTA Act 2009*. NICTA is expected to be fully operational in the first quarter of 2011.

7.3.1.2 Electricity

Improving the production and supply of electricity to most areas of the country is important in minimising costs for businesses and households that depend on it to sustain their operations and livelihood. The Government is in the process of finalizing an Electricity Industry Policy to guide the industry's development. Through this policy, the Government expects to make electricity services more accessible, reliable and affordable in PNG through greater private sector participation in electricity generation; incentives to enhance electricity services to rural areas; and improved regulatory arrangements.

A "third-party access" code will also be developed by the ICCC to encourage greater private sector participation. This code will set out clear terms and conditions for private generators to supply electricity into the existing transmission and distribution grid operated by PNG Power Limited (PPL). To encourage and enhance electricity services to rural areas, the Government proposed to establish a 'rural electrification fund. The proposed new regulatory arrangements will see the Department of Petroleum and Energy, rather than PPL take on responsibility for technical regulation of the industry.

7.3.2 Economic regulation (ICCC reviews)

To meet its economic regulation responsibilities in 2011, the ICCC will implement the recommendations of two pricing reviews completed in 2010 and undertake two regular contract reviews.

Pricing Reviews

Flour and Rice Industry

In 2010, the ICCC commenced reviews of the current price monitoring arrangements for the Flour and Rice industries in PNG.

The ICCC has completed the Final Determinations for the Flour Industry Pricing Review, which concluded that there is some merit to continue price monitoring of flour in PNG. This monitoring arrangement will continue until mid 2015. However, after 2013, industry stakeholders will have the opportunity to apply for full deregulation of the industry by the Commission if it is found that there is full contestability in the flour market.

For the Rice Industry Pricing Review, Final Determinations are expected to be completed by November 2010, with implementation of the new price regulation arrangements commencing in 2011.

The purpose of these ICCC pricing reviews is to ensure that PNG consumers are adequately protected.

Regulatory Contract Reviews

In 2011, the ICCC will continue to ensure that both PNG Power and Post PNG, which have monopoly characteristics, provide their services effectively and efficiently throughout the country through their regulatory contracts.

PNG Power Limited (PPL)

The current regulatory contract for the state-owned power utility, PPL will expire at the end of 2011. The ICCC will consider the terms and conditions of PPL's regulatory contract for the next regulatory period in 2011.

Post PNG

The ICCC is required to have in place a new Regulatory Contract for Post PNG from 1 January 2011. As such, the ICCC will introduce the terms and conditions of Post PNG's new regulatory contract in 2011.

7.3.3 Improving Public Infrastructure

The Government is determined to improve and maintain critical public infrastructure because this stimulates economic growth. In particular, better condition and accessible transport and utility infrastructure will help contribute towards reducing the cost of doing business in PNG.

To address the current capacity and funding constraints in public infrastructure development, the private sector can play a key role in providing and maintaining critical infrastructure throughout the country through the Government's Public Private Partnership policy.

7.3.3.1 Financing infrastructure through Public Private Partnerships (PPPs)

The Government recognizes the need to access private sector expertise and capital to develop and maintain the country's public infrastructure. The Government has developed a National PPP policy to encourage private sector involvement in developing public infrastructure projects. The inter-agency Government task force progressing this policy is nearing completion of a PPP Law and Regulations to establish a National PPP Centre. The PPP Centre will act as a central advisory body for PPP project proposals thereby promoting private sector confidence in the Government's PPP process. The key function of the Centre will be to evaluate the viability of a project being carried out as a PPP. The Centre is expected to be fully operational during the first half of 2011.

7.3.4 Establishing Effective Markets

The Government will continue to assist the establishment of effective markets where they do not already exist, as well as providing sound regulation to ensure existing markets operate effectively. Well functioning markets will improve resource efficiency leading to competition benefits. In order to establish effective markets, more work is done on the following sub-points on National Land Development Program, Housing Policy and Microfinance.

7.3.4.1 National Land Development Program (NLDP)

Since its inception in 2005, the NLDP has achieved significant milestones. Recent studies carried out by the National Research Institute (NRI) suggest that successful implementation of the NLDP program will lead to substantial GDP growth over the next decade. This will increase investment, create additional employment, and assist in addressing the current supply side constraints in housing.

The key goal for the NLDP in 2011 will be the establishment of the NLDP office. This office will be responsible for overseeing the implementation of the NLDP program.

7.3.4.2 Housing Policy

In January 2010, the ICCC released the Final Report of its review into the Housing and Real Estate industry in PNG. The report recognized that high prices and lack of affordability are only symptoms of broader failures, particularly in relation to an insufficient supply of land.

The report recommended that a holistic approach be undertaken to address PNG's housing scarcity problems and noted that coordination within the National Government agencies and the relevant arms of the Provincial and Local Level Governments could be improved to increase residential construction.

To implement the recommendations of this report, a National Housing Policy Inter-Agency Committee (HPIC) has been established. The HPIC will develop a National Housing Policy for consideration by Government in 2011.

7.3.4.3 Microfinance

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their microenterprises.

To develop the Microfinance sector, the Government, with funding and technical assistance from the Asian Development Bank (ADB), has been undertaking a Microfinance Expansion project since 2001. The objectives of the project are to increase the capacity of microfinance lending institutions and increase the volume of loans and savings in the rural population.

In 2011, key goals of the project will be to strengthen the regulatory capacity of the Bank of Papua New Guinea, as well as to establish a "risk-share" facility to encourage capable microfinance institutions to increase lending to genuine business proposals.

7.3.5 Reducing Impediments to Business and Investment

In an international survey by the World Bank in 2009, PNG was ranked 102 out of 183 countries in terms of the costs of doing business. Reducing impediments to business and investment is a key priority of Government because this reduces costs for businesses and promotes private sector development and growth. As part of the Government's ongoing effort in addressing private sector issues, the Government will undertake the following initiatives as key priorities in 2011.

7.3.5.1 Review of the Companies Act 1997

The Investment Promotion Authority (IPA) is currently undertaking legal reforms to improve the efficiency of its overall operations. This includes a full review of the *Companies Act 1997*. The aim of this review will be to identify impediments potential investors face in setting up a business in PNG. The recommendations of the review are expected to be implemented in 2011.

7.3.5.2 Reforms to secured lending arrangements

Currently, lenders are often unwilling to provide loans that are secured by personal property in PNG, for example lenders will not recognise personal property such as a motor-vehicle as collateral when considering a loan in case it has been concurrently used as collateral to other lenders. Therefore, the Government is reviewing the current legal framework to identify ways of providing greater confidence to lenders in order to encourage more secured lending arrangements. A potential reform could include the establishment of a single “asset registry” so that information can be made available to lending institutions regarding the collateral offered by prospective borrowers. The Government will look towards establishing and implementing these secured lending reforms in 2011.

7.3.5.3 Tariff Reduction Program (TRP)

The Government has made a decision in 2008 to implement a further TRP. This decision was based on the recommendations of the two independent tariff reviews conducted in 2003 and 2007 in which they concluded that businesses and consumers have benefitted from the Government’s TRP of 1999.

In November 2010 a review on TRP was approved by the NEC. A key objective of this review is to encourage the development of more efficient and internationally competitive industries that maximise PNG’s comparative advantages. The TRP will reduce input costs for many businesses, reduce the costs of development activities in PNG, and reduce the price of consumer goods. The TRP will make PNG’s exports more competitive on world markets and boost growth in export industries. Further detail is contained in Chapter 6.

7.3.6 Improving the performance of SOEs and Statutory Authorities

State-Owned Enterprises (SOEs) and Statutory Authorities (SAs) provide many important services and maintain much of PNG’s critical economic infrastructure. These entities also have a significant impact on the Government’s fiscal position. Consequently, the Government will continue to seek improved performance and governance of SOEs and SAs in 2011.

7.3.7 Community Service Obligation policy for SOEs

The Government signed a Memorandum of Understanding (MOU) with the ADB in May 2010 to develop a Community Service Obligation (CSO) framework for SOEs in PNG.

The essence of this policy is for the SOEs to improve the efficiency of CSO service delivery, improve the value for money of CSOs and ensure that CSO delivery does not negatively impact the performance incentives or commercial objectives of the SOEs.

Establishing a framework for managing CSOs is a critical component of SOE reform, improved public financial management and service delivery. This framework will provide increased transparency into the operations of the SOEs.

A CSO Working Group consisting of the Departments of Treasury, National Planning and Monitoring, Public Enterprises and the Independent Public Business Corporation was formed following the signing of the MOU to work alongside the ADB in developing the CSO policy framework. The CSO Working Group will finalize the CSO legislation and supporting guidelines in 2011.

CHAPTER 8. DEVELOPMENT STRATEGY

8.1 2011 DEVELOPMENT BUDGET STRATEGY

8.1.1 Overview

The Development Budget strategy determines the prioritisation of investments in the Development Budget. The formulation of the Development Budget reflects the Government's commitment to implement its policies, consistent with the Medium Term Development Plan (MTDP 2011-15) and Development Strategic Plan 2010-2030 (DSP), and to improve the quality of life of all Papua New Guineans.

The 2011 Development Budget strategy aims to build the **Foundation for Economic Growth and Prosperity**, which is consistent with the theme of MTDP. The 2011 Development Budget targets high impact and productive investments, providing access and opportunities to the rural majority and improving progress towards achieving the Millennium Development Goals (MDGs).

As per the DSP vision, to become a middle income country by 2030, the 2011 Development Budget builds the foundations for sustained economic growth and development by addressing the supply-side constraints. Investment in quality, accessible social and economic infrastructure in the rural areas will yield large returns for economic growth and development. In particular, the 2011 Development Budget strategy prioritises transport infrastructure. Transport infrastructure not only enables the movement of goods and services but has spill-over effects into a number of other sectors, for instance agriculture, manufacturing and tourism.

There are high demands on the Development Budget, with K8,974.4 million of submissions. Fixed commitments, totalling K794.4 million, must also be met through the Development Budget. The Development Budget strategy prioritises the remainder of Government direct financing across all sectors of the economy, with particular focus on the seven MTDP enablers. Crucially, the approach to achieve a sound foundation and progression towards becoming a middle income country by 2030 is structured around:

1. Ensuring the Budget is *policy-driven* and in line with MTDP enablers;
2. Appropriation of funding across all sectors of the economy in a suitable manner, but with particular focus on the enablers so as to maximise social and economic returns; and
3. The relationship Government wishes to form between its spending and that of its Development Partners.

8.1.2 MTDP 2011-2015 and Budget alignment

The 2011 Development Budget is the first annual budget of the DSP and MTDP. The DSP is the Government's strategy for realizing the long term goals and visions as enshrined in the Constitution of Papua New Guinea.

The MTDP is the first of four five-year plans to implement the DSP and it is the country's first action plan, explaining what will be done over the next 5 years in order to achieve the DSP goals. Within MTDP the detailed deliverables are supported by:

- Five year specific targets and indicators for each sector, including nationally tailored Millennium Development Goals (MDG) indicators and targets;

- Targets for the remaining three MTDPs to ensure we 'stay on track';
- Identification of risks and assumptions to ensure sectors coordinate and link with each other;
- Demarcation of the respective agency's responsibilities; and
- Projected estimated resource requirements to implement the plan.

All agencies and institutions of Government, as directed by NEC, must now align their plans, strategies and programs to the MTDP. Following alignment, sector funding will be based on implementing agencies and provincial Government annualising their programs and activities to achieve the desired deliverables detailed in the MTDP as well as satisfactory reporting on implementation. Implementing agencies, sub-national governments, and development partners will be held accountable to achieve the desired targets. As such, MTDP promotes results-based monitoring and a performance based culture throughout the public service.

Successful investment in the seven key enablers of the MTDP will result in a significant impact on the PNG economy over the next five years. Therefore, effective implementation of the MTDP requires a significant proportion of the Budget to be allocated to the MTDP enablers, and crucially to the enablers' *policies*. Under the Development Budget, 80 per cent of Government expenditure (direct financing, tax credit and loans) will be expended on intervention programs, thus implementing the first year of the MTDP. Of this per centage, 70 per cent will be allocated to the MTDP enablers' policies. The enablers are:

1. Unlocking **land** for development;
2. Improving **law, justice and order**;
3. Establishing quality national **transport** corridors that connect rural populations to markets and services;
4. **Higher and technical education** to redress the severe skills shortage within PNG's labour force ;
5. Universal access to quality **primary and secondary education** ;
6. The provision of key **utilities** of electricity, clean water and sanitation and communications; and
7. Improving **health** outcomes.

Non-MTDP expenditure in 2011 includes payment of constitutional grants, development grants, and other government services.

To fully implement the MTDP, over the next five years the Government will strive to increase the proportion of the Budget allocated to MTDP policy objectives. To achieve this requires Government to reduce the funding of expenditure items which are not detailed in the MTDP and closely align the Recurrent and Development Budgets. Crucially, the Government will ensure that the allocation of resources through the Development Budget is driven by policy and respective sector strategies and no longer purely expenditure driven as was the case under the previous Medium Term Development Strategy (2005-10).

Progress towards achieving the targets and deliverables under the MTDP can also be met through financing projects delivered by the private sector, the churches and NGOs, which may have a comparative advantage in the delivery of particular services. The Public Private Partnership Policy, Church-State Partnership Policy and CSO-State Partnership Policy are examples of such initiatives to deliver infrastructure and basic services more efficiently and cost-effectively. Effective collaboration, coordination and alignment between implementing

agencies and non-state actors is crucial. Equally, encouraging competition is a low cost policy that facilitates both economic progress and efficient delivery of services. Introducing competition into the mobile phone sector for example, has generated an unprecedented improvement in phone services throughout PNG.

Underpinning the Government's success in implementing policy priorities in the first and subsequent MTDPs is the public sector's performance and governance issues. High standards of public sector management involve high standards in the various institutions, departments and agencies through which the Government conducts its business. In addition, increased funding directed at the provincial and district level, in line with the MDG 'hotspots', has the potential to have an increased impact in the rural areas. This approach should be supported by strengthening of lower levels of government to ensure funds are spent in line with plans aligned to the MTDP.

8.1.3 Balancing spending across MTDP sectors

Successful implementation of the MTDP will depend on how well development expenditure is led by sector policy. Furthermore, guided by the Sequencing Principle, the timing of expenditure in one area will take place prior to that in another. The Sequencing Principle considers:

1. Spending in areas with the greatest **spillover effects** onto other expenditure areas. For example, expenditure in transport rehabilitation and maintenance supports the delivery of basic goods and services and promotes income-earning opportunities.
2. Spending in areas to **reduce future cost** to Government and society. For example, investing in the law and justice sector now will reduce the accumulated cost to the economy, Government and society over time.
3. Spending in areas where there is a **long lag between expenditure and outcomes**. For example, achieving a highly skilled and educated workforce throughout the country will take time and therefore requires us to begin investing now.

For instance, in line with the Sequencing Principle, transport infrastructure will be a focus of Government as it is an enabler for growth and development. Within the transport sector, investment in maintenance, rehabilitation and the construction of new roads in line with existing policy will be undertaken.

Transport, the provision of public utilities and the secure supply of energy are all needed to facilitate investment across the economic sectors of PNG, from agriculture to manufacturing to tourism. However, the costs of providing this infrastructure are lower and the returns are higher when land is accessible, when crime is not an impediment, when funds are well managed, and when providers are competing by offering higher service at lower prices. At the same time, better infrastructure helps to reduce the cost of providing basic services. Investment in the enablers will create a virtuous cycle of growth, establishing the foundation for PNG's prosperity under the DSP.

Similarly, education is given a high priority in the MTDP. While the benefits of primary and secondary education will not manifest until about 10 years later, an educated population and highly productive workforce will be essential by then to ensure the success of the DSP. Higher education is also a key priority to equip the workforce to implement the DSP and build the nation.

8.1.4 Relationship between Government and Donor Expenditure

In 2011, the Government is committed to increasing dialogue with development partners to advance the work and targets agreed under the PNG Commitment on Aid Effectiveness, signed in July 2008. This commitment localized the Paris Declaration Principles to improve aid effectiveness and included the following principles:

1. **Government ownership**;
2. **Alignment** of development partners' programs and strategies to PNG's development policies;
3. **Harmonisation** of development partners' country assistance strategies and requirement that development partners use Government systems and processes;
4. **Managing for development results**; and
5. **Mutual Accountability**.

The Government is committed to ensuring that the programs and expenditure of development partners are aligned to Government policies detailed in the MTDP. With clear targets and deliverables set out in the MTDP for each sector, the Government will in 2011, take strong leadership and ownership of development expenditure to ensure that donor expenditure is in line with MTDP policies. Furthermore, in 2011, the Government intends to introduce measures to screen and ensure donor funds are aligned to Papua New Guinea's development priorities as contained in the MTDP and DSP.

Issues that will be tackled in 2011 include: establishing and operationalising a national and sectoral dialogue system for development partners and Government central and line agencies to meet the principles of the PNG Commitments to Aid Effectiveness; strengthening of the Development Assistance Database to improve management of donor assistance expenditure and projections; and continuing to ensure recurrent funding implications are considered when development partners fund capital expenditure projects.

Existing Country Assistance Strategies and Programs will be reviewed to align with the MTDP for the 2012 Budget, recognizing that the 2011 Budget is transitional in nature. Existing development partnerships, including the PNG-Australia Partnership for Development will be reviewed and revised to ensure greater alignment and focus.

Increased harmonization of programs among donors, and the strengthening and employment of Government financial, management and procurement systems will be encouraged where possible. Particular attention will be given to the strategic use of technical advisors in capacity development programs, with the overall target of reducing the level of technical assistance as a percentage of total foreign aid. Over the next five years, the Government intends to reduce the total value of technical advisors in real terms to less than 50 per cent of total aid. Usage of technical advisors will be strategically placed in appropriate sectors, subject to proper screening and consultation, and greater use of Government recruitment process will be employed.

8.2 DEVELOPMENT BUDGET 2011

8.2.1 Overview

There are four sources of funding in the Development Budget: Government direct financing, tax credits, donor grants and concessional loans. In 2011, the total Development Budget is

K4,041 million. This comprises of 62.0 per cent from Government sources (direct financing, tax credits and loans) and 38.0 per cent from donors in the form of grants.

Table 28 summarises the 2011 Development Budget and compares it to the 2010 Development Budget. The figure for grants is higher than in previous years due to depreciation of the Kina against the Australian dollar, a significant increase of resources from AusAID in Kina terms and smaller increases from other donors. Tax credits are estimated to stay the same as in 2010 and concessional loan draw-downs are estimated to significantly increase.

Table 28: 2010 and 2011 Development Budget (Kina Million)

	2010	2011	Change	Change (%)
Total Government Financing	2,099.9	2,514.9	415.0	19.7
<i>Government Direct Financing</i>	1,771.5	2,066.6	295.1	16.6
<i>Tax Credits</i>	60.0	60.0	0.0	0.0
<i>Concessional Loans</i>	268.9	388.4	119.5	44.4
Donor Grants	1,293.9	1,526.1	232.2	17.9
Total	3,394.3	4,041.0	646.7	19.0

Source: Department of National Planning and Monitoring

In 2011, there are a number of fixed State commitments which must be funded from the Government direct financing appropriation. These total K794.4 million, or 38.0 per cent of Government direct financing, and are detailed in Table 29. Given the level of fixed State commitments and K8,974.4 million of submissions, prioritisation of the remaining Government resources is of paramount importance. After accounting for the Government commitments, only K1,272.2 million of Government direct financing remains to be allocated to new and ongoing projects.

A large proportion of the 2011 Development Budget will fund ongoing projects which were previously approved in the 2010 Development Budget. New projects under the 2011 Development Budget include one-off expenditure items such as PNG Ports' purchase of a mobile harbour crane, and projects in line with the sector interventions detailed in the MTDP, for instance funding of community health posts and rehabilitation of four national high schools. The new and ongoing projects (excluding fixed commitments) in the 2011 Government direct financing component are 28.0 per cent and 33.0 per cent respectively.

Table 29: Government Fixed Commitments (Kina Million)

	2011 Budget
District Service Improvement Program (DSIP)	178.0
High Impact Projects (LNG)	100.0
Infrastructure Development Grant (IDG)	120.0
National Agriculture Development Plan (NADP)	109.0
Loan Counterpart	104.0
Special Support Grants (SSGs)	66.8
District Support Grants (DSGs)	54.5
Memorandum of Agreement (MoAs)	32.1
Social Development Program (SDP)	30.0
TOTAL	794.4

Source: Department of National Planning and Monitoring

There are a number of high impact projects under the 2011 Development Budget, shown in Table 30. Significant resources target transport rehabilitation, a key enabler under the 2011 Development Budget. Other key areas of Government direct financing include health and primary and secondary education.

Table 30: Government Direct Financed Projects/Programs (Kina Million)

	2011 Budget
District Services Improvement Program (DSIP)	178.0
Infrastructure Development Grant (UBSA)	120.0
National Agriculture Development Plan (NADP)	109.0
Loan counterpart	104.0
High Impact Projects (LNG)	100.0
Rehabilitation and construction of 13 hospitals	84.8
Rehabilitation of Education Sector Infrastructure (RESI)	70.0
2011 National Census	66.0
National Road Maintenance Program (five highways)	60.0
Economic Corridor Development Programme	50.0
Rehabilitation of four National High Schools	40.0
TOTAL	981.8

Source: Department of National Planning and Monitoring

8.2.2 MTDP Development Budget allocation: Government contribution

Within the 2011 Development Budget, K2,012.6 million or 80.0 per cent of Government's appropriation is allocated to implementation of the MTDP. Of this amount, K1,418.8 million or 70.0 per cent is directly allocated to the seven MTDP enablers, and an additional 70.0 per cent is estimated to be spent on the MTDP enablers through Government development and constitutional grants. Table 31 details the level of Government direct financing expenditure on MTDP and non-MTDP interventions.

Non-MTDP expenditure items include those associated with general Government administration (Example, policy design support of K3.0 million, aid administration like support to the EU Institutional Capacity Project of K300,000 and other Government services such as the Social Development Program of K30.0 million) in part funding the Church-State Partnership and the CSO-State Partnership.

Other non-MTDP expenditure items include constitutional grants (District Support Grants) and development grants (Special Support Grants (SSGs) and Memorandum of Agreements

(MoAs). It is estimated that 70.0 per cent of both constitutional and development grants will be expended on MTDP aligned projects and initiatives. However, the monitoring and alignment of projects under the State commitments to MTDP policies needs to be strengthened.

Table 31 : 2011 GoPNG Direct Financing: MTDP and non-MTDP expenditure (Kina Million)

	Total	Percentage
MTDP expenditure (excluding CGs and DGs)	1,624.3	78.6
Non-MTDP expenditure (including CGs and DGs)	442.3	21.4
Total GoPNG direct financing	2,066.6	100.0
MTDP expenditure (including CGs and DGs) ²	1,866.6	90.3
Non-MTDP expenditure (excluding CGs and DGs)	200.0	9.7
Total GoPNG direct financing	2,066.6	100.0

Source: Department of National Planning and Monitoring

Table 32 shows Government's contribution by MTDP enablers. The loans are predominantly used for the transport sector, whereas the Government's direct financing component is spread across the seven MTDP enablers.

Table 32 : GoPNG's 2011 Development Budget contribution to MTDP enablers

	Direct Financing	Tax Credits	Loans	Total GoPNG
Transport	359.0	0.0	141.8	500.8
Law, Order and Justice	62.0	0.0	0.0	62.0
Health	186.3	0.0	0.0	186.3
Primary and Secondary Education	174.0	0.0	46.9	220.9
Higher and Technical Education	93.0	0.0	61.7	154.7
Utilities ³	131.5	0.0	60.1	191.6
Land	102.5	0.0	0.0	102.5
TOTAL	1,108.3	0.0	310.5	1,418.8

Source: Department of National Planning and Monitoring

Education (primary, secondary, higher and technical) and health will receive considerably more funds in 2011 in comparison to the allocation under the 2010 Development Budget. Moreover, for a third year in a row, transport remains the highest funded priority area for the Government.

Table 33 details non-MTDP expenditure, including constitutional and development grants.

Table 33 : 2011 GoPNG Development Expenditure on non-MTDP priority areas (Kina Million)

² An estimated 70 per cent of CGs and DGs will be expended on MTDP aligned projects and initiatives.

³ Utilities include electricity, water, sanitation and communications

	2011 Budget
General Government Administration	44.8
Other Government Services	111.0
Aid Administration	0.25
Constitutional Grants (CGs)	54.5
Development Grants (DGs)	291.7
TOTAL	502.3

Source: Department of National Planning and Monitoring

8.2.3 MTDP Development Budget allocation: Development Partners' contribution

Within the 2011 Development Budget, Donors grant of K1,384.4 million or 91.0 per cent is allocated to implementation of the MTDP. Table 34 details the level of donor expenditure on MTDP and non-MTDP interventions. Non-MTDP expenditure items include those associated with general government administration for instance parliament and legislative processes (K3.6 million) and other government services, such as non-state actors support programs (K65.8 million). It is further estimated that a proportion of MTDP associated expenditure will contain an 'aid administration' component; however, information on the breakup of donor expenditure needs to be strengthened.

Table 34: 2011 Development Partners' Grant Financing: MTDP & non-MTDP Expenditure (Kina Million)

	Total	Percentage
MTDP expenditure	1,384.4	90.7
Non-MTDP expenditure	141.6	9.3
TOTAL Development Partners' grant financing	1,526.1	100.0

Source: Department of National Planning and Monitoring

An estimated 46.0 per cent of donor grants are spent on the MTDP enablers, with the majority of assistance targeted to the areas of transport (14.0 per cent), primary and secondary education (14.0 per cent) and health (8.0 per cent). The remaining per cent of total donor assistance is predominately allocated to the governance sector (16.0 per cent) and HIV/AIDS sector (10.0 per cent). Table 35 shows Development Partners' contribution by MTDP enabler.

The ratio of Government to donor expenditure has changed substantially from 2010 to 2011, with the ratio of Government to donor grants increasing in health, primary and secondary education and higher and technical education. The Government has allocated significantly more funds towards the enablers than donor grants in the 2011 Development Budget. The ratio of Government to donor expenditure in the transport sector has decreased, however including the K120.0 million Infrastructure Development Grant into 2011 Government transport expenditure, as was done in 2010, increases the ratio to 3:1.

Table 35: Development Partners' Grant Contribution to MTDP enablers (Kina Millions)

	2011 GoPNG Development	2011 Donor Grants	2010 Ratio	2011 Ratio
Transport	500.8	207.4	3:1	2:1
Law, Order and Justice	62.0	83.2	1:1	1:1
Health	186.3	124.8	1:3	1:1
Primary and Secondary Education	220.9	208.3	1:2 ⁴	1:1
Higher and Technical Education	154.7	36.4	3:1 ⁵	4:1
Utilities ⁶	191.6	32.6	n/a	6:1
Land	102.5	11.9	n/a	9:1
TOTAL	1,418.8	704.6	1:2	2:1

Source: Department of National Planning and Monitoring

8.2.4 MTDP Recurrent and Development Budget Allocation

Table 36 shows both Government recurrent and development expenditure on the MTDP enablers in 2011. The Government has allocated K4,175.6 million to the enablers out of the total of K7,801.8 million or 53.4 per cent. Compared to 2010, the Government is allocating more funds towards health, education and law, order and justice relative to donor grants.

Table 36: 2011 GoPNG Total Expenditure Versus Donor Expenditure (Kina Million)

	2011 GoPNG Recurrent & Development	2011 Donor Grants	2010 Ratio	2011 Ratio
Transport	757.7	207.4	4:1	3:1
Law, Order and Justice	749.5	83.2	7:1	9:1
Health	841.0	124.8	3:1	6:1
Primary and Secondary Education	1,127.4	208.3	4:1 ⁷	5:1
Higher and Technical Education	325.3	36.4	6:1 ⁸	9:1
Utilities ⁹	242.9	32.6	n/a	7:1
Land	131.8	11.9	n/a	11:1
TOTAL	4,175.6	704.6	4:1	6:1

Source: Department of National Planning and Monitoring

⁴ In 2010 the ratio refers to "Basic Education".⁵ In 2010 the ratio refers to "Development Orientated Adult Education".⁶ Utilities include electricity, water, sanitation and communications⁷ In 2010 the ratio refers to "Basic Education".⁸ In 2010 the ratio refers to "Development Orientated Adult Education".⁹ Utilities include electricity, water, sanitation and communications

8.3 MONITORING DEVELOPMENT

There remains significant work to improve monitoring of activities. This results from lack of statistical data and monitoring systems necessary to measure progress in development. Since 2005, data and statistics accompanied by analysis have become increasingly high on the development agenda. The Government has now established a number of initiatives to improve PNG's data collection system, and the capacity of the National Statistical Office (NSO), in order to serve the purpose of effective statistical administration and thorough evidence based decision making.

The following list details the data systems currently in place to monitor development. The latter three are programs that will address PNG's data requirements, and are currently being finalized.

- The annual MTDS Performance Management Framework (PMF) since 2007, monitors progress in the MTDS priority areas. This will be replaced by the MTDP Results Monitoring Framework (RMF) which will track progress towards the MTDP enablers;
- PNGInfo contains data on the progress towards the PNG Millennium Development Goals (MDGs) and other relevant development indicators;
- The PNG Development Assistance Database (DAD) keeps records of all donor funded projects (including financial details and key performance indicators);
- PNG's State of Development annual report (to be inaugurated in 2010);
- Monitoring and evaluation of the projects and programs under the Public Investment Program (PIP); and
- The National Strategy for Development Statistics (NSDS).

The NSDS when finalized and endorsed will be PNG's road map for statistics. It is envisaged to be implemented in 2011. The 2011 National Census as well as surveys essential for PNG's development (e.g. Agriculture Survey) will form part of the NSDS implementation and will not be done in isolation of provinces' efforts towards addressing data gaps.

8.4 FUTURE DEVELOPMENT BUDGETS AND STRATEGIES

Under the Medium Term Development Strategy (MTDS 2005-2010) minimal progress was made in meeting the basic needs of all Papua New Guineans. The recent MTDS review and Second National Progress Summary Report for the Millennium Development Goals note that child and maternal mortality and the HIV/AIDS prevalence rate continue to remain high, while primary school enrolment rates remain low. The performance of the MTDS expenditure priority areas on a scale of -5 to +5 was rated +2 on trend and +1 overall, with the majority of progress in the areas of macroeconomy and public expenditure management.

The MTDS review highlighted a number of lessons to be learned from the past five years including failure to align national and sub-national planning, objectives being too broad, lack of specific performance indicators or targets and lack of reliable data. Furthermore, a clear recommendation from the review was the need to establish clear strategies to attain the targets and maintain a continuous process of monitoring and evaluation. More effective engagement with development partners was also noted to be necessary over the medium term.

8.4.1 MTDP 2011-2015

Over the medium term, the Government will continue to focus on the key enablers and MTDP policies to build the foundations for economic growth and development. Furthermore, the systems and processes of Government will be strengthened and improved, including the Government's ability to monitor and track progress towards achieving the DSP vision. The MTDP outlines key targets, strategies and deliverables for each sector, thereby clearly highlighting the way forward over the next five years and providing a set of measurable indicators with which to track progress. Nonetheless, monitoring the impact of the Development Budget is a formidable challenge, due to the various funding sources that contribute towards development outcomes.

An estimated resource envelope of K66.6 billion is required to effectively implement the MTDP over the five year period. Table 37 details how this amount could be broken up across the Development and Recurrent Budget over the medium term.

Table 37: MTDP Estimated Resource Envelope (Kina Billion)

	2011	2012	2013	2014	2015	Total
Total Resource Envelope	9.1	12.0	13.6	14.9	16.9	66.6
Development Budget	4.5	6.1	6.5	7.0	8.4	32.5
<i>Government (DF and TCS)</i>	3.2	3.5	3.7	4.7	6.4	21.5
<i>Donor grants</i>	1.2	1.5	1.4	1.4	1.4	6.8
<i>Loans</i>	0.2	1.2	1.3	1.0	0.6	4.3
Recurrent Budget	4.6	5.1	6.0	6.5	7.1	29.3

Source: Department of National Planning and Monitoring

Over the five year period, tax revenue is estimated to increase, however a financing gap to implement MTDP is expected. As such, from 2012 onwards debt financing within the Development Budget will be considered to address the funding shortfall and ensure MTDP is effectively implemented. Debt financing will be in line with the reviewed Medium Term Debt Strategy and Medium Term Fiscal Strategy, ensuring that debt stock as a percentage of GDP is sustainable over the medium term, taking into account the Government's wider contingent liabilities.

8.4.2 MDG Hotspots

Future Development Budgets will also take into account the equity spread of development expenditure and in particular the MDG 'hotspots'. Hotspots are defined as areas (provinces/districts/LLGs) that lag behind the national average in MDG achievement: health (maternal and child health, HIV/AIDS, malaria, TB and other diseases), basic education, gender equality, poverty, employment, hunger and use of clean energy, potable drinking water, improved sanitation, secure tenure, and information and communication technology (computer, internet and telephone).

In 2000, the provinces which lagged behind the national average in youth (15-24 year old) literacy rate of 61.7 per cent were Southern Highlands, Enga, Eastern Highlands, Western Highlands, Chimbu, Gulf and West Sepik. During the same year the male-female difference in youth literacy rate was higher than the national average of 5.5 per cent in Chimbu, Gulf, West Sepik, Eastern Highlands, Madang, Enga, Morobe, Western Highlands, and East Sepik.

Provinces that had a higher infant mortality rate compared to the national average (64 per 1000 live births) in 2000 were West Sepik, Gulf, Morobe, East Sepik, Madang, Enga, Milne Bay and Western. During the same year life expectancy at birth was less than the national average of 54.2 years in West Sepik, Madang, Gulf, Morobe, East Sepik, Enga and Milne Bay.

The above-mentioned areas which have lagged behind the national average in development indicators need urgent attention and future Development Budgets will seek to improve their socio-economic indicators.

8.4.3 Strengthening Institutional Capacity to Deliver Services

Effective implementation of the MTDP requires a collaborative approach by all stakeholders to deliver on the targets set by Government. In this regard, the Government is formulating the National Planning legislation to establish the country's national planning system that will integrate bottom up and top down planning approaches. This will standardize the policy process, improve service delivery and abolish the current ad-hoc planning, especially at the sub-national level. The new legislation will be supported by the four regional planning offices by enabling improved interactions between the national and lower levels of Government. In addition, localization of the MDGs at the provincial levels (currently being piloted in four provinces) will ensure lower levels of Government planning are in line with national plans and policies, namely the MTDP and the DSP.

Alignment of all plans and policies of the Government will greatly assist in the coherent and effective implementation of public investment programs to achieve national targets. Increased alignment of sector plans and policies to the MTDP and DSP will enable the Government to achieve its medium to long term goals. The National Health Plan 2011-2020 is the first plan to align to the DSP and the MTDP. Moreover, equipped with clear targets, strategies and deliverables for each sector in the MTDP, more dialogue with Development Partners will ensure a collaborative approach is taken towards achieving the desired development outcomes.

Within the public sector, encouragement of a performance-based culture, supported by regular reporting on the MTDP sector targets, an effective monitoring framework and disciplined sectoral coordination will help Government achieve its desired objectives. The detailing of deliverables and targets within the MTDP will address the problems of non-reporting by implementing agencies and provincial administrations by holding them accountable for funds that have been disbursed to them and ensuring these are translated into the desired deliverables. To this end, governance, public sector management, and overall capacity will improve.

CHAPTER 9. SECTORAL POLICIES

9.1 MEDIUM TERM DEVELOPMENT PLAN ENABLERS

9.1.1 Land

The National Land Development Program (NLDP) strategic framework (2011-2020) provides the overall policy directives for the land sector. The overall goal for the NLDP is to unlock land for development. Currently, 3.0 per cent of land in PNG is owned by the State and the remaining 97.0 per cent is customarily owned. The NLDP Implementation Plan 2011-2015 further details the priorities of the program over the first five years of implementation. Key strategic priorities of the program include: Land Administration Support, Incorporated Land Group (ILG) and Dispute Resolution Support and Customary and Alienated Land Development. The NLDP is in line with the Government's commitment to increase land use within the formal administration system to over 20.0 per cent of PNG's land mass and to have at least 60.0 per cent of landowner groups registered as ILGs by 2030. These targets have been set out in the DSP and in the first five years, under MTDP, Government aims to unlock 7.0 per cent of customary land for development purposes.

The pressing need for land is to address outdated land related legislations and an inefficient and lengthy land administration system. Progress has been made in addressing these issues. Under the Office of Urbanisation two pilot projects are under way to form ILGs in order to register and unlock land for development. Furthermore, court services in the provinces have been established in partnership with the Magisterial Services to improve dispute administration and management system at the lower levels of government. However, challenges remain, particularly in efforts to access and use customary land for development.

In 2011, Government funding will focus on the key components of the NLDP which includes Land Administration Support, ILG and Dispute Resolution Support, Customary and Alienated Land Development, and Institutional and Capacity Building. In addition to Land Administration Support, Government funding to unlock land will include the construction of two 'missing links' (Baiyer-Madang and Bogia-Angoram) and piloting of four economic corridors through the Economic Corridor Development Programme.

In comparison to previous budgets, Government funding in 2011 is expected to increase. This is in support of focusing expenditure on the enablers, the Government's key focus areas outlined in the MTDP. Table 38 shows the level of development funding from the Government and development partners since 2005.

Table 38: Development Appropriations for Land 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	0.4	0.0	0.0	0.0	0.4
2006	0.5	0.0	0.0	0.0	0.5
2007	2.3	0.0	0.0	0.0	2.3
2008	2.5	0.0	0.0	0.9	3.4
2009	6.0	0.0	0.0	0.9	6.9
2010	6.0	0.0	0.0	9.6	15.6
2011	102.5	0.0	0.0	11.9	114.4

Source: Department of National Planning and Monitoring

Table 39 shows the major programs and projects targeting land development being funded in the 2011 Development Budget.

Table 39: 2011 Development Expenditure on Land (Kina Million)

	Government	Grants	Total
Economic Corridors Development Programme	50.0	0.0	50.0
National Land Development Program	10.0	5.7	15.7
Border Development Mapping Project	2.0	0.0	2.0
Baiyer-Madang Missing Link	20.0	0.0	20.0
Bogia-Angoram Missing Link	20.0	0.0	20.0
Other	0.5	6.2	6.7
Total	102.5	11.9	114.4

Source: Department of National Planning and Monitoring

9.1.2 Law and Justice

The current high levels of crime and violence not only reduce the quality of life of people in both the rural and urban areas, but it is costly to the nation as a whole, undermining access to basic goods and services and impeding economic growth. The poor law and order situation often leads to the destruction of assets within a community, such as aid posts and schools, and criminal activity discourages business and investment, thus hindering economic growth. Currently, the annual incidence rate of major crimes committed is estimated to be around 600,000, with 150,000 cases reported in 2005. Reporting systems are weak and as such only an estimated 20-30 per cent of crimes are reported. The average victimization rate is 9.7 per cent across urban centres, including burglary, assault, sexual assault, violence, vandalism and vehicle theft.

The 2007 White Paper on Law and Justice in PNG and the National Law and Justice Policy and Plan of Action 2000 set out the overarching policy directions for the Law and Justice Sector. These policies focus on improved functioning of the formal law and justice system, improved sectoral coordination and resource use and increased focus on crime prevention and restorative justice.

Both policies are implemented through the Law and Justice Sector Strategy Framework (LJSSF) with the goal of achieving *"A Just, Safe and Secure Society in PNG"*. The LJSSF focuses on five key areas:

1. Improved policing, safety and crime prevention;
2. Improved access to justice and just results;

3. Improved reconciliation reintegration and deterrence;
4. Improved accountability and reduced corruption; and
5. Improved ability to provide law and justice.

The Government is committed to achieving the DSP target to reduce crime rates by 55.0 per cent and the victimization rate to below 5.0 per cent by 2030. Over the next five years, the MTDP period, Government will work towards reducing the current crime rate of 91 per 1000 to 70 per 1000 and the estimated annual crime incidence rate from 600,000 to 520,000.

The National Coordinating Mechanism (NCM) leads the promotion of the Law and Justice Policy and the LJSSF, including in policy and budget matters and provides oversight and direction through the Law and Justice Secretariat (LJSS). The LJSS supports the Government's sector-wide approach through increased coordination of procedures and activities, monitoring of sector performance and management of the central imprest account mechanism. Diversion from the LJSS's mandated functions and poor reporting has been an issue in recent years and a review of the Secretariat in 2010, funded by AusAID, will inform the Government on how best to address the role of LJSS in future years.

The sector is responsible for a range of functions and only through effective coordination and support will the system operate effectively as a whole. For instance, the removal of the backlog of cases in the National and Supreme Courts will reduce the number of remandees awaiting trial and relieve pressure on Correctional Service. Solving disputes early at the community level by increasing the skills of police and village court officials and improving the payments system of village court officials will slow the growth in cases reaching the higher courts.

At the national and provincial levels, the formal principal law and justice agencies work with civil society through the Community Justice Liaison Unit (CJLU) to ensure local levels of restorative justice and crime prevention are strengthened. Further support to the sector in 2011 will come in the form of an infrastructure development policy which is currently being developed by the sector. This policy will guide and coordinate the infrastructure plans of the law and justice agencies and will ensure that facilities are of an adequate standard and maintained.

It is clear that implementation across the sector must be strengthened in order to address the current high levels of crime and violence. However, one of the key challenges faced by the sector is the issue of deteriorating facilities, in particular the state of correctional services, police housing, the National and District Court Houses and the rural lock-ups. Other critical areas for the sector include the provision of legal aid at the provincial level, addressing juvenile justice and training of key personnel. The Government takes note of these issues and expenditure in 2011 will focus on the infrastructure rehabilitation. This investment builds upon work carried out in 2010 and is in line with the priorities of the Government to increase the capacity and effectiveness of the sector agencies.

Table 40 details the level of Government and Donor support to the sector throughout the MTDS period (2005-2010). Overall, since 2005, the level of Government funding from the Development Budget has increased and the level of donor support has decreased. However, in 2011, the level of donor funding is greater than that of Government direct financing. Whilst the total amount allocated to the sector is less than the 2010 appropriation, the total allocation to implementing agencies through the Development Budget is K3.5 million higher

than in 2010. In contrast to the 2010 Development Budget, support to the sector will not be provided through the District Service Improvement Programme (K35.6 million in 2010).

Table 40: Development Appropriations for Law and Justice 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	13.5	10.0	0.0	510.3	533.8
2006	26.8	0.0	0.0	76.6	103.4
2007	30.5	0.0	0.0	96.0	126.5
2008	31.0	0.0	0.0	108.3	139.3
2009	10.0	0.0	0.0	96.0	106.0
2010	94.1 ¹	0.0	0.0	72.2	166.3
2011	62.0²	0.0	0.0	83.2	145.2

¹ Includes DSIP law and justice funding (K35.6 million).

² Does not include DSIP law and justice funding.

Source: Department of National Planning and Monitoring

Table 41 details the major programs which will be funded in 2011. The Government has allocated substantial amount of development funds towards tackling the deteriorating infrastructure in the sector, including the rehabilitation of four police stations, three jails and three police housing complexes. Over the medium term, it is the policy of Government to enhance the capacity of law and justice implementing agencies and rehabilitate infrastructure in the sector.

The Australian Government will continue to fund the PNG-Australia Law and Justice Partnership Program, aimed at supporting the sector through advisors and funding of the Law and Justice Secretariat. A component of the partnership also targets capital works and in comparison to 2010, the Government will invest a larger proportion of total funds to improve critical infrastructure in the sector.

Table 41: 2011 Development Expenditure on Law and Justice (Kina Million)

	Government	Grants	Total
Police Logistics	20.0	0.0	20.0
Morobe police housing	3.0	0.0	3.0
Eastern Highlands police housing	2.0	0.0	2.0
Tambul/Nebilya police barracks	3.0	0.0	3.0
Boram jail relocation/extension	10.0	0.0	10.0
Rural lock-up program	8.0	0.0	8.0
Mukrumanda jail construction	3.0	0.0	3.0
Kwikila police station	2.0	0.0	2.0
Boroko police station	2.0	0.0	2.0
Wewak police station	2.0	0.0	2.0
Angoram police station	2.0	0.0	2.0
PNG-Australia Law & Justice Partnership	2.0	74.4	76.4
Other	3.0	8.8	11.8
Total	62.0	83.2	145.2

Source: Department of National Planning and Monitoring

9.1.3 Transport

Papua New Guinea's diverse and challenging geography means that reliable land, air and water transport infrastructure is crucial to the social and economic advancement of the country and the overall wellbeing of its people. Improved transport infrastructure facilitates access to markets and the flow of basic goods and services to both rural and urban communities. However, the state of transport infrastructure across the country is poor and it is deteriorating rapidly. For a number of years there has been inadequate maintenance of existing assets. As such a large amount of funding is required for rehabilitation work. This is the case for all three modes of transport (land, air and water).

The total road network in PNG is approximately 30,000km, of which 8,460km are national roads. Annual data is recorded on the national road network under the Road Asset Management System (RAMS), with each 10km stretch of road classified as either: good, fair or poor. Location and traffic volume data is used to identify the appropriate level of aggregation. In 2010, 30.4 per cent of national priority roads are in "good" condition. This is an improvement from the percentage recorded in 2008 (29 per cent). Under the DSP, the Government is committed to obtaining the target of 100 per cent of 25,000km of national roads in good condition by 2030. To reach this target, Government will work towards ensuring less than 1,200km of national roads are in poor condition, whilst increasing the size of the road network to 10,000km over the medium term.

Thirteen out of twenty-two airports have been fully ICAO certified and the Government is working towards the MTDP target of 100 per cent of regional airports meeting international certification by 2015. This will be through the leadership of the National Airports Corporation (NAC), following the restructuring of the sector in 2010. The previous Civil Aviation Authority (CAA) functions were allocated to three agencies: NAC, Civil Aviation Safety Authority (CASA) and PNG Air Services Limited (PNGASL). CASA is now responsible for air safety, PNGASL is responsible for managing PNG's airspace and NAC is responsible for managing all national airports. Ensuring that all airports provide a safe and secure operating environment is a legal requirement under the Civil Aviation Act 2000 and continues to be a top priority of the Government. The Civil Aviation Development and Improvement Program (CADIP), a multi tranche financing facility through ADB, will address this priority.

PNG Ports Corporation has increased its maintenance and development activities targeting Lae Port, through concessional ADB loan financing. At the same time, the corporatization of PNG Ports under the Independent Public Business Corporation (IPBC) has enhanced its capability to effectively address issues affecting sea port facilities. Under the DSP, the maritime sector will work towards achieving the targets of reducing the turnaround time from 3 days to 1 day, upgrading ports and tripling the number of routes serviced and number of vessels by 2030. By 2015, it is anticipated that the turnaround time will have been reduced from 3 days to 2.5 days and the number of routes serviced and number of vessels increased by 25.0 per cent, as detailed in the MTDP. The Government will also continue to focus on rehabilitating jetties and wharves to serve the coastal communities of PNG.

In 2011, the transport sector will be guided by the National Transport Strategy 2011 -2030 (NTS) which will be implemented through a five-year Medium Term Transport Plan (MTTP 2011-2015). The NTS is due to be completed by the end of 2010. Both new plans are aligned to the MTDP and DSP.

The goal of the NTS is to work towards establishing a transportation network that links all of PNG. The NTS features a longer time-frame than previous plans and identifies strategic infrastructure (importance vs. investment priorities) and new approaches to cost recovery. It also examines Community Service Obligations, coordination between state agencies and stakeholders (through Government's Transport Sector Coordination Monitoring and Implementation Committee – TSCMIC), safety, security and clearer accountability for effective service delivery. Under the NTS, Government will focus on:

- Basic maintenance: 'good' and 'fair' condition national roads will be maintained over the full 20-year horizon to prevent deterioration;
- Rehabilitation: applied to 'poor' quality national roads to upgrade them to 'fair', plus maintenance for the rest of the 20-year period;
- Upgrading: any national road from existing condition to 'good' quality;
- Bridge improvements: bringing any bridges on a link that is below the capacity of 'fair' up to 'good';
- Construction of 16 missing links and economic corridors;
- Increasing shipping services;
- Reducing port turnaround time; and
- Upgrading airports and reopening rural airstrips.

The NTS was informed by the Transport Infrastructure Priority Study (TIPS) funded by AusAID. TIPS is producing a model to assist prioritisation of investment in the transport sector from both an economic and social development perspective. Unlike the 2006 TIPS, TIPS 2010 considered all three modes of transport and covered infrastructure at both the national and provincial levels. Crucially TIPS provides Government with the projected economic benefit from investment in critical areas and informs stakeholders on an appropriate sequencing policy for the transport sector. However, the prioritization methodology used under TIPS is predominately based on economic factors and does not adequately factor in community service obligations. As such, care was taken in interpreting and using the findings from TIPS. TIPS will be finalized by the end of 2010.

As in the 2009 and 2010 Development Budget, the transport sector remains the highest funded area under the Development Budget and receives over 37.0 per cent of all concessional loans. This relative funding allocation is justified by the sequencing principle encapsulated in the Development Budget strategy. Expenditure on transport will produce spillover effects on to other expenditure areas, for example the delivery of basic health and education services and the promotion of income-earning opportunities. The Government's commitment to fund the transport sector through direct financing, tax credits and loans is detailed in Table 42.

However, whilst the relative funding allocation for the transport sector was high between 2005-2010, funding fell short of the major capital investments required in all three sub-sectors – land, air and water. Aside from the level and allocation of funding, other constraints exist in the sector. Poor prioritisation of funding, delays in the procurement and approval process of Government, a lack of qualified engineers and technical staff, security issues and landowner issues continue to plague the sector.

Table 42: Development Appropriations for Transport 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	105.6	69.2	137.5	211.5	523.8
2006	193.1	71.1	100.5	173.7	538.4
2007	159.8	85.4	132.3	185.9	563.4
2008	148.0	73.7	116.4	220.8	558.9
2009	283.3	40.0	131.2	197.9	652.4
2010	475.9 ¹	60.0	150.4	214.5	900.8
2011	359.0²	0.0	141.8	207.4	708.2

¹ Includes Infrastructure Development Grant funding (K120 million) and two 'missing links' (K40 million)

² Excludes Infrastructure Development Grant funding (K120 million) and two 'missing links' (K40 million), which are accounted for elsewhere.

Source: Department of National Planning and Monitoring

The major items in the 2011 Development Budget for transport rehabilitation and construction are shown in Table 43. Recognizing the lack of funding for the maritime and air sub-sectors in recent years, Government will fund all forms of transport in the 2011 Development Budget.

For the road sub-sector, K60.0 million has been allocated for the rehabilitation of five highways: trans Sepik Highway, trans East-West New Britain Highway, Buluminski Highway, Central-Malalaua Highway and Kokopau to Arawa road upgrading and bitumen sealing. In contrast to the 2010 Budget, the national bridge maintenance program will be budgeted for in the Recurrent Budget and not the Development Budget (K40.0 million). A further K60.0 million for the national road maintenance programme has also been appropriated in the Recurrent Budget.

In the 2011 Development Budget concessional loan funding is being sourced from the Asian Development Bank (ADB) for programs covering all three modes of transport. This includes the Lae Port Development Program, the Civil Aviation Development and Improvement Programme and the Highlands Region Roads maintenance and improvement program under an ADB multi tranche financing facility.

In 2011, other donors, including JICA and AusAID will continue their grant financing in the road sub-sector. The PNG Australia Partnership for Development recognises the need to improve transport infrastructure and in 2011 AusAID will continue its Transport Sector Support Programme, which targets maintenance and rehabilitation of the 16 national roads as well providing some funds towards maintenance of national airports, ports and airport certification in line with the NTS and MTDP. JICA will continue its support to rehabilitate Markham Bridge in Morobe Province and the bridge programme in Bougainville.

Table 43: 2011 Development Expenditure on Transport (Kina Million)

	Government	Loans	Grants	Total
DSIP – rural and feeder roads	178.0	0.0	0.0	178.0
Trans Sepik Highway	10.0	0.0	0.0	10.0
Trans East-West New Britain Highway	10.0	0.0	0.0	10.0
Buluminski Highway	10.0	0.0	0.0	10.0
Central Malalaua Highway	10.0	0.0	0.0	10.0
Kokopau to Arawa Road upgrading	20.0	0.0	0.0	20.0
Highlands Region Road Improvement	10.0	48.0	0.0	58.0
Lae Port Development	0.0	21.9	0.0	21.9
Mobile Harbour Cranes	30.0	0.0	0.0	30.0
Coastal Vessels	20.0	0.0	0.0	20.0
Community water transport	8.0	6.0	0.0	14.0
Civil Aviation Development and Improvement Programme	8.0	21.9	0.0	29.9
Transport Sector Support Programme	0.0	0.0	136.4	136.4
Other	45.0	44.0	71.0	160.0
Total	359.0	141.8	207.4	708.2

Source: Department of National Planning and Monitoring

9.1.4 Higher and Technical Education

Higher and technical education is crucial for supplying the country's manpower requirements in all sectors of the economy and a highly skilled workforce will drive growth and development. Currently the number of skilled workers is low in PNG and the Government recognises the need to address this issue as a priority.

For example, PNG currently has less than one doctor and less than one health worker per thousand people. This is low in comparison to the average amongst the developing countries considered to be particularly poorly supplied with health workers. PNG's (indirectly measured) youth literacy rate is 61.7 percent and adult literacy is 49.2 per cent. Furthermore, one-third of skilled jobs are currently held by foreigners, resulting in an estimated K780.0 million leaving the country every year in the form of foreign remittances. The DSP and MTDP recognize the importance of addressing these issues and have set the targets of 112,000 graduates in 2015 and 265,000 in 2030 to address the shortage of skills in the adult population.

The National Education Plan 2005-2014 is the guiding policy framework for technical and vocational education. The Higher Education sector is guided by the National Higher Education Plan II, however work is underway to finalize the National Higher Education Plan III, 2011-2020. Under the plan, the Government has identified a number of necessary interventions in the higher education sector, guided by the findings of the PNG University Review. Key strategic areas for the Government over the medium term include:

- Higher education reform, lead by the Commission for Higher Education;
- The rehabilitation, or replacing, of run-down existing assets, and restoration of quality before investment in expansion;
- Repair and expansion of the national high schools to improve on the quality of intake to universities;
- Provision of information and communication technology in universities; and

- Forging of strong partnerships with relevant stakeholders, including dialogue with PNG industry.

Table 44 shows appropriations for Higher and Technical Education over the MTDS period (2005-2010). Under MTDS higher and technical education was not an expenditure priority area. However, the EPA “development orientated adult education” focused investment on informal adult education in partnership with formal education systems. The significant increase in funds allocated to the higher and education sector in 2011 reflects the change in Government priorities under MTDP.

Table 44: Development Appropriations for Higher and Technical Education 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	2.9	0.0	6.1	31.2	40.2
2006	5.3	0.0	5.8	39.7	50.8
2007	11.2	0.0	5.1	51.5	67.8
2008	17.8	0.0	0.4	46.0	64.2
2009	43.6	0.0	0.0	50.0	93.6
2010	55.3	0.0	11.8	62.5	129.6
2011	93.0	0.0	61.7	36.4	191.1

Source: Department of National Planning and Monitoring

The major programs in the 2011 Development Budget targeting this DSP and MTDP enablers are shown in Table 45. The Government has recognized the importance of funding technical colleges and universities as well as scholarships to address the shortage of skills in the adult population.

Table 45: 2011 Development Expenditure on Higher and Technical Education (Kina Million)

	Government	Loans	Grants	Total
Unitech infrastructure development (HR)	16.0	0.0	0.0	16.0
Unitech petroleum & petrochemical engineering school	10.0	0.0	0.0	10.0
UPNG law school building	10.0	0.0	0.0	10.0
UPNG science building	8.0	0.0	0.0	8.0
UoV library	5.0	0.0	0.0	5.0
UNRE administration block upgrade	3.0	0.0	0.0	3.0
UoG dormitory extension	4.0	59.0	0.0	63.0
Trade Skills Scholarship	20.0	0.0	0.0	20.0
TVET sector projects	10.0	0.0	0.0	10.0
Other	7.0	2.7	36.4	46.1
Total	93.0	61.7	36.4	191.1

Source: Department of National Planning and Monitoring

9.1.5 Primary and Secondary Education

The overarching objectives for the education sector are encapsulated in the National Education Plan 2005-2014 and the Universal Basic Education Plan (UBE) 2010-2019. Key strategic priorities of these plans include: implementation of the education reforms to improve service delivery, strengthening and coordinating partnerships with stakeholders at all levels, enhancing universal access to basic education and ensuring effective distribution of education materials and supplies. Under the UBE plan, the Government aims to provide the opportunity for all children to complete eight years of basic education. Through implementation of these plans, the Government will meet its commitment to MDG Goal 2: Achieve Universal Primary Education.

The national MDG targets for PNG, stated in the MTDP, is to achieve a gross enrolment ratio of 74.3 per cent, a cohort retention ratio between grade one and six of 40.0 per cent and a youth literacy rate of 70.0 per cent. Currently, the completion rate to grade eight is 45.4 per cent. Overall, little progress towards achieving the national targets for enrolment (access to education), retention and achievement was made between 1990 and 2009 and given continuation of recent trends, PNG will not be able to achieve the global targets for MDG 2 by 2015. Much work needs to be done to meet the revised national targets detailed in MTDP 2011-2015.

The quality of education is also an area of concern for the Government. Since 2001 class sizes have steadily increased, and the number of school inspections has decreased. To substantially improve the quality of primary and secondary education, performance monitoring must be strengthened, teachers must be trained to higher standards and primary, secondary and national high schools must be adequately equipped with resources and an appropriate number of classrooms. Furthermore, secondary schools in turn must be well integrated with vocational and technical colleges to ensure continuity of education attainment throughout the system.

The expansion of the education sector since 1995 has put considerable pressure on existing resources, a pressure which is further compounded by high population growth rates. In particular there is considerable pressure in the capital cost of expanding infrastructure and the recurrent costs of additional teachers and their associated training requirements. Yet, insufficient numbers of teachers and resources in the rural districts and communities remains an issue. The capacity at all levels to monitor and administer the education system, as well as greater community and parental demands for access to education, has further put pressure on the sector to perform.

In responding to these challenges, the Government in 2011 will focus development expenditure on building capacity within the system. This includes rehabilitating existing primary, secondary and high school infrastructure, investing in new classrooms and providing sufficient educational materials.

The Government has increased funding to primary and secondary education over the life of the MTDS. Guided by the expenditure sequencing strategy basic education was an expenditure priority area under the MTDS. Under MTDP, one of the key enablers for growth and development has been identified to be primary and secondary education. As such the significant increase in funds to the sector in 2011 reflects an adjustment in Government priorities over the next five years. In 2011, donor grants account for 49.0 per cent of expenditure. In 2010 donor grants were estimated to be 71.0 per cent of expenditure.

Table 46: Development Appropriations for Primary and Secondary Education 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	5.7	0.0	0.0	170.4	176.1
2006	14.4	0.0	0.0	151.5	165.9
2007	26.9	0.0	0.0	74.4	101.3
2008	10.5	0.0	0.0	163.1	173.6
2009	30.8	0.0	0.0	144.8	175.6
2010	82.1	0.0	0.0	197.3	279.4
2011	174.0	0.0	46.9	208.3	429.2

Source: Department of National Planning and Monitoring

Major projects funded in 2011 are listed in Table 47.

Table 47: 2011 Development Expenditure on Primary and Secondary Education (Kina Million)

	Government	Loans	Grants	Total
Rehabilitation of Education Sector				
Infrastructure (RESI)	70.0	0.0	0.0	70.0
Rehabilitation of four National High Schools	40.0	0.0	0.0	40.0
Establishing library in every school project	11.0	0.0	0.0	11.0
Oro Recovery and Restoration Programme	20.0	0.0	0.0	20.0
Community Colleges	5.0	46.9	0.0	51.9
Procurement and distribution of secondary school books	0.0	0.0	27.3	27.3
New Education Delivery Strategy	0.0	0.0	74.7	74.7
Other	28.0	0.0	106.3	134.3
Total	174.0	46.9	208.3	429.2

Source: Department of National Planning and Monitoring

9.1.6 Utilities

Public utilities are fundamental to the growth and development of all sectors of the economy. Priority utilities in the MTDP are:

1. Water and sanitation;
2. Energy development; and
3. Information and Communication Technology.

9.1.6.1 Water and Sanitation

By regional Pacific standards, Papua New Guinea ranks low in terms of access to potable water and safe sanitation services. Only 40.0 per cent of the national population has access to potable water. And 45.0 per cent of the national population has access to adequate sanitation services. Within the rural community, clean and safe water is accessible to 32.0 per cent of the rural population while 41.0 per cent of the rural population has access to safe sanitation.

Papua New Guinea appears unlikely to achieve MDG 7, which aims to halve the proportion of people without sustainable access to safe drinking water and basic sanitation by 2015,

relative to 1990 levels. To address this, the Government has set the following targets in the MTDP: increasing the total population's access to improved water source from 40.0 per cent to 46.0 per cent and access to improved sanitation from 45.0 per cent to 50.0 per cent.

A number of government agencies are responsible for providing safe drinking water and sanitation to the citizens of PNG. These include the Department of Environment and Conservation, Eda Ranu, PNG Waterboard and the Department of Health. In particular, the Department of Health is responsible for the promotion of a clean water supply and improved sanitation in the rural areas. Under the National Health Plan 2011–2020 the safe water supply and sanitation priorities are:

1. Increase the number of households that have access to safe drinking water, and effective waste disposal and sanitation;
2. Ensure all health facilities have access to running water, and effective waste disposal and sanitation;
3. Ensure public and private buildings comply with legislation in relation to water supply, sanitation and food handling; and
4. Review and improve relevant legislation to enhance the management and control of rural water supplies.

To further support the utilities sector, the Government wishes to formulate a comprehensive National Water Policy in line with MTDP.

The Government has recognized that the private sector can play an important role in the provision of safe water and sanitation. Implementation of the Public-Private Partnership (PPP) policy, coupled with development of the Community Service Obligations (CSO) policy and associated legislation in 2011, are two mechanisms which the Government can draw upon to improve the delivery of safe drinking water and effective waste disposal and sanitation. Service delivery can also be improved through strengthening partnership with non-state actors. The Civil Society-State Partnership, signed in March 2010, helps foster strategic alliances with key stakeholders. This partnership is consistent with one of the underlying principles of the MTDP, which is to strengthen partnership and collaboration among all major stakeholders. Obstacles remain however, including the loss and poor distribution of water due to vandalism and illegal connections, lack of capacity in the management of water resources, and depletion and pollution of water resources.

Tables 48 and 49 indicate levels of funding towards water and sanitation and document the major programs in the focus area. Under MTDS, expenditure on water and sanitation was captured in the EPA – primary and preventative health. There are also a number of projects with donor support in the form of both grants and concessional loans. The EU is the only grant funding donor in the sector.

Table 48: Development Appropriations for Water and Sanitation 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	8.5	0.0	31.0	3.6	43.1
2006	16.5	0.0	27.8	14.1	58.4
2007	11.3	0.0	5.0	2.2	18.5
2008	11.6	0.0	13.8	33.2	58.6
2009	8.5	0.0	30.1	18.9	57.5
2010	42.7	0.0	35.0	31.6	109.3
2011	45.0	0.0	9.6	28.7	83.3

Source: Department of National Planning and Monitoring

In the 2011 Development Budget, the Government is funding a number of measures to improve people's access to safe drinking water and sanitation facilities. These are documented in Table 49.

Table 49: 2011 Development Expenditure on Water and Sanitation (Kina Million)

	Government	Loans	Grants	Total
POM sewerage	10.0	9.6	0.0	19.6
Goroka town sewerage	8.0	0.0	0.0	8.0
District town water supply	5.0	0.0	9.9	14.9
Water supply and sanitation programme	15.0	0.0	0.0	15.0
Other	7.0	0.0	18.8	25.8
Total	45.0	9.6	28.7	83.3

Source: Department of National Planning and Monitoring

9.1.6.2 Electricity

Electricity is an important input to production and hence growth and development. As such it is identified in the DSP and MTDP as an enabler for other sectors of the economy to thrive. However, the energy sector is currently underdeveloped in PNG, despite the country being rich in renewable and non-renewable energy sources.

PNG has substantial deposits of hydrocarbons, mainly natural gas. The recoverable, proved and probable natural gas resources are estimated at 428 billion cubic metres, equivalent to about 3 billion barrels of oil. The country is also rich in renewable energy resources suitable for power production, particularly hydropower. PNG has more than 15,000 megawatts (MW) of hydropower potential. Coconut plantations are widely spread throughout PNG and may be a potential source of power as coconut-based bio-diesel becomes a viable option. Other potential energy sources are geothermal, wind, solar and marine.

The most recently published data shows that only 12.4 per cent of households have access to electricity. Under the MTDP, it is anticipated that this will increase to 26.8 per cent of households, rising to 70.0 per cent by 2030. To address this, the Government has formulated the National Electricity Policy. The focus of the policy is increasing private sector participation and competition, particularly in generation activities and rural electrification. Currently 0.6 per cent of FDI is invested in power and major investment in electricity infrastructure is needed due to an expected five-fold surge in demand for electricity by 2030.

Under the Electricity Industry Policy, free entry of private sector producers will be allowed to serve large customers with loads of 10 MW or more alongside third party investment in

generation, retailing and network activities in areas outside current PNG Power Limited exclusive areas, which include rural areas. The framework uses a standard pricing in the shape of national single tariff and envisages an Electricity Trust Fund to finance subsidies for rural areas. Private sector generators can also be encouraged through the inclusion of 'feed-in-tariffs' in the electricity generation market. These tariffs will mean a guaranteed revenue stream for any new participants in the electricity generation market and thereby provide further certainty for long term investments in electricity generation. Competitions will be introduced in identified segments of the electricity markets. Where there is no competition, Community Service Obligation (CSO) will be applied. Work is currently underway to develop the Community Service Obligation Policy and associated legislation to guide the application of CSOs in the sector.

For effective implementation of the policy, regulation of the energy market must be strengthened. Presently, ICCC is the economic regulator of the industry and technical regulation is carried out by PNG Power Limited.

Table 50 shows the appropriations towards energy development throughout the MTDS period. As can be seen in the table below, the Government has increased funding towards this focus area over the last year. Development partner assistance has increased in recent years in the form of concessional loans.

Table 50: Development Appropriations for Energy Development 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	0.0	0.0	0.0	0.5	0.5
2006	2.3	0.0	0.0	7.6	9.9
2007	1.0	0.0	0.0	1.3	2.3
2008	2.0	0.0	0.0	0.2	2.2
2009	3.0	0.0	0.0	0.0	3.0
2010	13.0	0.0	0.0	0.0	13.0
2011	43.0	0.0	5.0	0.0	48.0

Source: Department of National Planning and Monitoring

The major programs targeting energy development are shown in Table 51. The Government has recognized the importance of funding electrification in the rural areas as well as the urban environment. The Town Electrification Programme, through concessional ADB loan financing will continue in 2011.

Table 51 : 2011 Development Expenditure on Energy Development (Kina Million)

	Government	Loans	Total
Rural solar capacitors	10.0	0.0	10.0
Rural electrification programme	30.0	0.0	30.0
Town electrification programme	3.0	5.0	8.0
Total	43.0	5.0	48.0

Source: Department of National Planning and Monitoring

9.1.6.3 Information and Communication Technology – ICT

Information and communication technology transforms PNG, linking rural communities to the wider world, increasing access to goods and services and increasing knowledge and information across the country.

Telecommunication services have benefitted from the introduction of private sector competition in the mobile phone industry. This has led to a substantial upgrade in the quality and reach of services and a significant decline in cost. As such there are currently 277 mobile subscribers per 1000 people, with an increasing number of subscribers every year. The fixed telephony network has approximately 65,000, 65.0 per cent of which are business lines. The level of access in the rural and remote areas is however lower than the urban centres. Currently, 2.3 per cent of the population has access to the internet; however internet broadband access remains expensive by international standards.

Acknowledging the benefits of ICT for the PNG economy it is current Government policy to roll out the benefits of competition throughout the telecommunications sector. This will enable Government to achieve the MTDP targets for the ICT sector: to increase the number of mobile subscribers to over 700 per 1000 people by 2015 and internet access by 20.0 per cent. The National ICT policy sets out the strategic directions for the sector including the introduction of staged open competition in the communications sector and transforming Telikom into a viable and efficient competitor in the market. Moreover, Government has undertaken a review of the current regulatory structures and processes mandating ICCC to be competition regulator, whilst PANGTEL will be a technical regulator, effective under the National Information Communication Technical Authority (NICTA) as a new licensing regime. This will ensure properly designed CSO mechanisms and interconnections regimes are established at the same time as open competition.

Reform and investment in the communications sector is required in order to extend availability to rural and remote areas of PNG. The costs in undertaking such initiatives are high due to PNG's rugged and remote terrain. As such, until the establishment of a well regulated open market, an equitable and properly managed CSO scheme must be considered. With open competition, traditional cross subsidies between services and geographic areas will become difficult to sustain. Work on the CSO policy and associated legislation in 2011 will help in this regard. Furthermore, with the recent engagement of the World Bank to assist in the establishment of the rural connectivity fund (RCF) and Universal Access Scheme, development of ICT services in rural areas of PNG will be enhanced.

Table 52 indicates the level of funding towards ICT over the last five years. This area has seen increased funding since 2005, in line with Government's policy to promote rural transformation and empowerment.

Table 52: Development Appropriations for ICT 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	0.3	0.0	0.0	0.0	0.3
2006	0.0	0.0	0.0	0.0	0.0
2007	0.0	0.0	0.0	0.0	0.0
2008	0.8	0.0	0.0	0.0	0.8
2009	7.0	0.0	0.0	0.0	7.0
2010	0.5	0.0	0.0	0.0	0.5
2011	43.5	0.0	45.4	3.9	92.8

Source: Department of National Planning and Monitoring

The major programs in the 2011 Development Budget targeting ICT development are shown in Table 53.

Table 53: 2011 Development Expenditure on ICT (Kina Million)

	Government	Loans	Grants	Total
Integrated Government Information System	2.5	41.4	0.0	43.9
Rural communications (WB)	1.0	4.0	0.0	5.0
Rural communication	10.0	0.0	0.0	10.0
National ID cards	30.0	0.0	0.0	30.0
Other	0.0	0.0	3.9	3.9
Total	43.5	45.4	3.9	92.8

Source: Department of National Planning and Monitoring

9.1.7 Primary and Preventative Health

The National Health Plan 2011 -2020 provides the overall policy and planning directives for the health sector. Its goal is to strengthen primary health care for all, and improve service delivery for the rural majority and urban disadvantaged. Strategic priority areas for the first ten years of this plan include: improving service delivery, strengthening partnership and coordination with stakeholders, strengthening of the health systems, improving child survival, improving maternal health, reducing the burden of communicable diseases, improving health lifestyles, and improving preparedness for disease outbreaks and emerging population health threats. The health sector Medium Term Expenditure Framework (MTEF) guides this approach by signifying the overall resource envelope accessible to the sector to assist the allocation of resources to the priority areas. The MTEF has expanded and improved over the last ten years to assist financing of the health sector in PNG.

To support the National Health Plan 2011 -2020, the Department of Health is currently in the process of formulating the Human Resource Workforce, the ICT and the Asset Management Policies.

Over the past decade there has been little or no improvement in the country's health status. The health sector is represented by low life expectancy at birth as a result of high infant and child mortality, a high maternal mortality rate as well as deteriorating health facilities. The 2006 Demographic and Health Survey indicates that infant mortality is 57 per 1,000 live births, under-five mortality is 75 per 1,000 live births whilst maternal mortality is reported to be 733 for every 100,000 live births (indirect estimate, circa 1994). Considering the present level of infant, under-five and maternal mortality and the trend over the last ten years, the global MDG targets for goal 4: reduce child mortality and goal 5: improve maternal health will not be achieved in the remaining six years of the first MDG cycle 1990-2015. Progress

towards the national target for MDG 4 has however been made and in 2009, the national target for under-five mortality has been achieved. However the trend in maternal mortality since 1990 suggests that the national MDG target set for 2015 is unachievable.

Over the next five years, the Government will work towards reducing infant mortality from 57 per 1,000 live births to 43, under five mortality from 75 per 1,000 live births to 56 and maternal mortality from 733 per 100,000 live births to 500. These targets are detailed in the first MTDP 2011-2015.

With only five years left of the initial MDG cycle 1990-2015, the global as well as the national targets for MDG 6: combat HIV/AIDS, malaria and other diseases also appear to be out of reach. According to the 2009 Annual Health Sector Review, immunization rates still remain relatively low with only 62.0 per cent of children under one year old immunized against measles per year and only 61.0 per cent with triple antigen (third dose) per year. Over the last two years, coverage of the 3 doses triple antigen has declined, whilst measles vaccine coverage has increased, in part due to supplementary immunization activities. In 2008, the malaria prevalence rate was 391 in high malaria endemic districts and the pneumonia case fatality rate of children under five years was 2.7 per cent (an increase of 0.3 per cent from 2007).

The causes of ineffective health service delivery are systemic and complex. Health infrastructure continues to deteriorate, medical supplies are insufficient and fragmentation of the health systems' structure has reduced service delivery at the provincial and district levels. For instance, over a period of nine years, the proportion of open registered aid posts in the rural areas decreased from 78.0 per cent to 71.0 per cent. The required recurrent funding must be made available to prevent further deterioration of health facilities and services and the roll out of Provincial Health Authorities (PHAs) in 2011 must be supported to overcome fragmentation in the delivery system. Efforts to ensure funds reach the service delivery frontline, supported by the District Treasury Roll-Out Program must also be strengthened.

Inadequate service delivery is also the result of poor progress in other sectors, for example poor transport infrastructure, law and order problems, low level of education, and a lack of continuous water and electricity supply. Only through focused investment on the supporting enablers will improvements in the health sector be fully realized.

In 2011, expenditure in the health sector will be focused on rehabilitation of existing infrastructure, trialing of community health posts in strategic locations and the procurement of vital medical equipment.

Table 54 shows the level of funding from Government and Development Partners since 2005. Since 2005 funding from both Government and Development Partners has consistently increased. From 2010 to 2011 funds allocated to the health sector by Government have increased by 152.0 per cent. Funds from Trust Accounts and recurrent expenditure are not reflected in Table 54.

Table 54: Development Appropriations for Primary and Preventative Health 2005-2011 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2005	1.0	0.0	0.0	9.5	10.5
2006	3.0	0.0	0.0	40.6	43.6
2007	12.5	0.0	0.0	78.3	90.8
2008	17.0	0.0	0.0	84.3	101.3
2009	39.6	0.0	0.0	109.8	149.4
2010	73.8	0.0	0.0	200.4	274.2
2011	186.3	0.0	0.0	124.8	311.1

Source: Department of National Planning and Monitoring

Development Partners continue to contribute significantly to the health sector, including AusAID, NZAID and the UN. Table 55 shows the major programs and projects being funded in the 2011 Development Budget. In addition to the major projects listed below, Government funds a number of smaller projects in rural areas including the rehabilitation of health centres and aid posts.

Table 55: 2011 Development Expenditure on Primary and Preventative Health (Kina Million)

	Government	Grants	Total
Specialist hospitals' feasibility studies	20.0	0.0	20.0
Rehabilitation and construction of 13 hospitals	84.8	0.0	84.8
Community health posts	13.0	0.0	13.0
Provincial transit medical stores	14.4	0.0	14.4
Replacement of priority medical equipment	10.0	0.0	10.0
Static plant equipment replacement	7.0	0.0	7.0
Cuban doctors (MDG 4 & 5 special intervention)	25.0	0.0	25.0
Medical research	2.0	4.9	6.9
Health sector resourcing framework	0.0	50.3	50.3
Other	10.1	74.5	84.6
Total	186.3	124.8	311.1

Source: Department of National Planning and Monitoring

For Development Partners' contribution to the health sector, the Health Sector Improvement Program (HSIP) is a mechanism to pool Government and donor funds. However, to date, a range of issues including insufficient capacity to move funds to provinces and facilities, confusion in roles and responsibilities and development partners' policies and legal frameworks have prevented the sector wide approach from operating effectively. For effective implementation of the National Health Plan 2011-2020, improvements to the Health Sector Improvement Program (HSIP) must be made.

9.2 ECONOMIC SECTORS

9.2.1 Agriculture

The agriculture sector contributes around 25.0 per cent to GDP and 19.0 per cent to total exports from its major commodities which include coffee, copra, oil palm, rubber and timber.

The agriculture sector remains the principal economic activity in PNG, sustaining the livelihood of more than 85.0 per cent of the population residing in the rural areas.

The Department of Agriculture and Livestock (DAL) is a mandated agency responsible for the overall development of the agriculture sector. Other agencies such as the National Agriculture Research Institute (NARI), Cocoa Copra Research Institute (CCRI), and associated commodities boards are the implementing agencies responsible for executing the policies, legislation and development plans put forward by DAL to improve and increase the production of each agriculture commodity.

The National Agriculture Development Plan (NADP) 2007 – 2016 provides the overall policy and planning directives for the agriculture sector. The NADP aims to sustainably transform the country's agriculture sector into a vibrant and productive economic sector that contributes to economic growth, social wellbeing, national food security and poverty alleviation. To achieve this vision, the NADP is committed to developing a well coordinated planning and implementation strategy that is both interactive and effective and involves the full participation of stakeholders. The eight priority areas under NADP are: research and extension, information and training, food and horticulture crop development, tree and industrial crop development, livestock, apiculture and aquaculture development, spice and minor crop development, gender, social and HIV/AIDS related issues, regulatory and technical services and strengthening of NADP management and coordination.

In 2008, the Government agreed to fund NADP at a cost of K100.0 million annually for ten years. Implementation of NADP commenced in 2009 and in 2011, the Government has committed K109.0 million to fund NADP. K89.0 million will be allocated to the districts and K20.0 million will be allocated to the National Development Bank for the provision of a credit facility for private ventures involved in agriculture.

Funding of the agriculture sector in the 2011 Development Budget will also include support to the commodity boards, the national spice promotion and development programme and the National Agriculture Research Institute (in addition to NADP research funds) to ensure the agriculture sector is equipped to manage risks associated with climate change and natural disasters. NARI's research on disease and drought tolerant crops, biological control of weeds and high yielding crops will be disseminated to smallholder farmers through agricultural extension.

Indirect support to the sector in 2011 will also come through significant investment in the rehabilitation of the deteriorating transport network, assisting producers to take their crops to the market, and support to the national land development programme. Improvements in land administration will increase opportunities for market based large scale and smallholder agriculture, employment and income generation in the rural area.

Though an estimated 30.0 per cent of land in PNG is suitable for agriculture, only 4.0 per cent is currently being utilized for commercial agricultural production.

9.2.2 Fisheries

The fisheries sector supports the livelihoods of many coastal communities in PNG. The sector is characterized by inland river fisheries, aquaculture, coastal bêche-de-mer, reef fisheries, prawn trawl and large-scale deepwater tuna fisheries. Stakeholders include artisanal communities to medium sized domestic prawn and tuna long-line operators to large international purse seine fleets in the deepwater tuna fishery. It is estimated that the value of

the fisheries sector is K350-K400 million per annum. However, calculating the contribution of the fisheries sector to the economy is a difficult task due to high subsistence consumption and transactions in the local market and payment of crews in kind.

PNG has the potential to benefit greatly from the fisheries sector as it has the largest fisheries zone in the Pacific, covering an area of 2.4 million square kilometres. Recognizing this potential, the Government endorsed the National Fisheries Development Plan Framework (NFDPF) 2006-2016. Key priorities under the NFDPF include: increasing the volume and value of downstream processed products, promoting fish products of internationally recognized quality, encouraging sustainable fishing, improving fishing communities' access to markets, and encouraging the vertical and horizontal linkages between supportive markets. The NFDPF will drive the Government's commitment to increase processed fisheries' exports from K189.0 million to K450.0 million, the quantity share of catch caught by PNG vessels from 1 per cent to 5.0 per cent and the license fees generated from tuna fisheries from K60.0 million to K100.0 million over the MTDP period (2011-2015).

It is estimated that 34.0 per cent of the total fisheries output is processed locally at a value of K189.0 million. Greater value to the sector, employment and income earning opportunities for rural people, could be further enhanced by increasing the number of onshore downstream, and product diversification processing facilities for fish and fisheries products. There are currently four commercial canneries and processing plants in PNG. This includes the new tuna processing plant currently being constructed by Majestic Seafood Corporation in Lae. The Lae processing plant will eventually process 350 metric tonnes daily to the value of K375.0 million per annum and will provide 6,000 jobs.

To further support the development of downstream industries, the Government aims to make fisheries an efficient commercial industry by promoting and creating fisheries zones complete with the necessary infrastructure and government services. With the establishment of Marine Industrial Zones, the Government hopes to increase Foreign Direct Investment (FDI) from 0.8 per cent to 5.0 per cent. The Pacific Marine Industrial Zone (PMIZ) in Madang is the first of such kind. The PMIZ is a joint initiative of the National Government, Provincial authorities and major industry players including RD Tuna. Its aim is to become the regional tuna trans-shipment and processing hub for the Western and Central Pacific, through the establishment of six canneries processing 600 metric tonnes of tuna a day. The project is fully funded through a concessional loan from the Chinese Government. It is expected that the project will provide 40,000 direct jobs with a multiplier effect of approximately five with the support industry and spin-offs opportunities for the local surrounding communities.

PNG has substantial stocks of tuna within its Exclusive Economic Zone, some of which have been exploited by foreign fishing vessels paying access fees in exchange for fishing rights. License fees are low and there is an incentive to overfish. K60.0 million is currently generated annually through license fees, however there is the potential to collect over K100.0 million annually. The Government has adopted a policy of domestication of its tuna fishery, which involves encouraging domestic long-line vessels and expanding the proportion of the purse seine catch taken by locally based vessels supplying domestic canneries. Further development of the tuna fishery will take the form of a change in the balance between the long-line and purse seine fisheries, or a change in the allocation of the purse seine catch. Moreover, compliance of quality, standards, Sanitary and Phytosanitary (SPS) measures, and rules of origin will increase the potential for the fisheries sector to access international markets. In particular PNG will be able to fully utilize the Interim Economic

Partnership Agreement signed with the European Union in 2009, giving access to the lucrative European market duty and quota free.

Through funding of the following programs in the 2011 Development Budget: coastal fisheries development programme (K15.0 million) and PMIZ (K55.0 million) the Government will continue to support the sector. The Coastal Fisheries Development Program is an import development and policy initiative to enhance and harness the fisheries potential of local fishermen. This program will be executed by the newly established Coastal Fisheries Development Agency (CFDA).

9.2.3 Forestry

PNG has a total land area of 46 million hectares, of which two thirds is forested. Of this, it is estimated that 15 million hectares is rich in timber species that are acceptable and accessible for development. The Government is committed to ensuring PNG's forest resources are managed so as to derive maximum sustainable benefits while minimizing any detrimental impact to the environment and society at large. As such, the Government has set the following targets for the forestry sector: increase the share of processed timber from 20.0 per cent to 30.0 per cent by 2015, decrease the share of logs harvested from natural forest and increase the share of plantation forests by 18,000 over the five year MTDP period.

The development of the sector is guided by the Forestry Act and the National Forest Plan. The National Forest Plan and National Forest Development Guidelines detail how the national and provincial governments intend to manage, utilize and develop the country's forest resources. Key strategic priorities of the plan include: improved administration capacity, promotion of local and provincial interest in the industry, development of diversified markets, promotion of forest management through reforestation and afforestation, establishment of a State Market Agency (SMA), promotion of forest research and downstream processing to phase out log export. Work is underway to formulate supporting policies in the areas of downstream processing, reforestation and eco-forestry. Future policy areas include forest research and non-timber forest products. To further improve service delivery and enhance implementation of the National Forestry Plan, appropriate sections of the Forestry Act were amended and endorsed by Parliament in May 2010. These amendments relate specifically to the selection of foresters and will ensure that the selection process is aligned to public procurement processes.

The forestry sector is dominated by large scale logging activities in West New Britain, East New Britain, Western and Gulf provinces. The major logging crops are Taun, Malas, Kwila, and Calophyllum for export to China, Korea and India, the largest buyers of PNG timber. From January-May 2010, the total volume of log exported was 1,099,687m³, providing K69,070 million and K8,473 million in the form of export duty and export levy to Government and other stakeholders.

The Government is committed to achieving sustainable forest management and addressing climate change. Noting the role that forests play in reducing greenhouse gases, the Government has identified four strategic ways to mitigate climate change: increase the per centage of forested land, increase the carbon density of existing forests, substitute fossil fuels and other carbon intensive products with sustainably produced forest products and implementation of the Reduced Emissions from Deforestation and Forest Degradation (REDD) and REDD+ concept under the leadership of the Office of Climate Change and Development (OCCD). REDD + comprises REDD and Sustainable Forest Management (SFM) and conservation.

To this effect, the PNGFA drafted the Forestry and Climate Change Policy Framework for Action 2009-2015. The Framework for Action reaffirms the state's commitment towards a number of international agreements including the MDGs, Copenhagen Accord, Johannesburg Plan of Implementation, UN Commission on Sustainable Development, UN Framework for Climate Change Convention, UN Convention on Biodiversity, UN Convention to Combat Desertification, Intergovernmental Panel on Climate Change and Reduced Emissions from Deforestation and Forest Degradation (REDD and REDD+). PNG has also become part of a "Coalition of Rainforest Nations", to further give support to the REDD and REDD+ initiatives. The PNGFA as the responsible agency is committed to implement the framework in conjunction with the Department of Environment and Conservation and the newly established Office of Climate Change and Development (OCCD). In 2011 the PNGFA will continue work on developing pilot projects for possible REDD projects. Work must also take place on formulating clear national guidelines on the legal status of carbon sinks and carbon ownership in native forests, as market and information failure, coupled with lack of awareness on REDD by landowner groups, has led to the emergence of unsolicited private sector initiatives. A voluntary and 'parallel' market currently exists, led by the private sector, which secure carbon credits from Clean Development Mechanism (CDM) projects.

To oversee implementation of the sustainable forest management principle the Government has developed a logging code of practice and PNG is a member country to the International Tropical Timber Organisation (ITTO). Under the ITTO PNG reports on its progress towards achieving SFM against a set of internationally agreed criteria and indicators for natural tropical forests. The PNGFA is the agency responsible for implementation of the SFM principle, in which forest concessions are acquired under the Forest Management Area (FMA) system. Under this arrangement, the concession holder can operate within the timber concession for 35 years. Within 35 years residual or undersized trees left behind by the initial logging operation will have grown to an acceptable size (more than 50cm diameter breast height), and the renewable resource can be managed and developed in a sustainable manner until the next cutting cycle. Logging enterprises are also required to develop and follow various forest working plans (annual five year logging plans). The plan specifies methods for practicing selective logging. It is important to note however the enormity of task in monitoring the SFM principle. The vast land areas that are required to be covered with diverse terrain, weather pattern, ecological systems, type and quality and timber sources necessitates close consultation all levels of Government, non-government organizations, customary landowners and logging companies' forest inventory/survey teams.

In 2011, the Government will support the forestry sector through expenditure on the following programs: forest research institute rehabilitation and support for sustainable forest management. Support to the sector will also come from the Japanese Government in the form of a grant. The JICA supported Forest Preservation Program will minimize capacity and data access problems currently faced by the Papua New Guinea Forest Authority (PNGFA) in achieving sustainable forest management.

9.2.4 Tourism

There is significant potential to expand the value of the tourism sector (currently approximately 3.0 per cent of GDP) through marketing of PNG's natural beauty, cultural richness, world class diving, deep sea fishing, unique bird watching, trekking and surfing. The tourism industry also has the potential to boost employment opportunities, spin-off businesses and help preserve PNG's unique environment and culture. The MTDP has set the target for the sector of increasing visitor numbers to 213,666 over the five year period, contributing K2.6 billion in total tourism receipt and generating an additional 5,100 jobs. This

will set PNG on a road towards reaching the DSP target of 350,000 visitors and K5.0 billion in total tourism receipt in 2030.

The Tourism Master Plan 2007-2017 (TMP), under the leadership of the Tourism Promotion Authority, is the overall guide for the tourism sector with the goal of “increasing overall economic value of tourism to the nation by doubling the number of tourists on holiday in PNG every five years as well as to maximize sustainable tourism growth for the social and environmental benefits for all Papua New Guineans”. Key strategic priorities of the plan include: transport and infrastructure, human resource development, institutions and industry partnership, marketing the destination, and product development and investment. In 2010, the PNGTA became a member of Eco-tourism Australia and it is hoped that this will boost visitor numbers to PNG.

Based on the annual visitor reports, the number of visitor arrivals increased from 120,134 in 2008 to 125,891 in 2009, of which the majority of the inbound market was for business travel. Whilst the trend is expected to increase, with 8.5 per cent growth predicted over the next ten years, the number of holiday visitors fell over the two year period from 34,719 in 2008 to 30,497 in 2009. However, the estimated total foreign earnings from tourism in 2009 amounted to K391.0 million, compared to K300.0 million in 2007. The average daily expenditure per visitor is estimated to be K967.97. However, PNG's share of the South Pacific regional market remains small, with only 5.0 per cent of total arrivals, and less than 2.0 per cent of the holiday market.

The goal to double the number of tourists on holiday in PNG every five years will be a challenge. The Government will need to continue to support the TMP, and the projects recommended under it. The promotion of taxation incentives for tour operators and hotelier sub-sectors marketing PNG overseas must be encouraged, the capacity of the hospitality sector must be strengthened and efforts to stimulate competition in the tourism market, particularly in the accommodation sub-sector must be supported. Indirect support to the sector will also be needed in the form of consistent funding to the enabling environment. An increase in the competitiveness and standard of transport infrastructure is required, alongside improvements in the law and order situation, provision of safe drinking water and sanitation and reliable electricity and ICT services. Through creating a conducive environment the industry will be able to flourish and the PNG will be able to compete with other Pacific countries for tourists.

The Government remains committed to the sector, indicated by an appropriation of K1.0 million in the 2011 Development Budget for global PNG brand awareness. The Small and Medium Enterprise Tourism Loan Facility (SME TLF), facilitated through the NDB, is one program that supports SMEs in the industry, in particular those in the rural areas which have greater tourism potential. In the 2011, an additional K5.0 million is allocated to the SME TLF, which saw 7 projects successfully utilizing the fund in 2010.

9.2.5 Oil and Gas

Since the 1990s, the oil and gas sectors have been the second largest contributors to GDP, driving PNG's growth and development.

The oil and gas sector is guided by the *Oil and Gas Act 1998*. This act has guided the sector with the focus of improving the management and development of oil and natural gas resource extraction in the country. The current oil fields are estimated to be depleted by 2026 whilst gas production is expected to increase substantially over the next decade,

driven by the Government's commitment to the development of two Liquefied Natural Gas (LNG) projects.

The first LNG project is located in the Southern Highlands and an Agreement was signed between the Government of PNG and ExxonMobil on 22nd May 2008. The LNG project has an expected project life of 30 years with production scheduled to start in 2014. Construction has started at the project site at an estimated cost of approximately US\$15.0 billion (real terms). The effects on the PNG economy will be large and the Government must manage economic risks, such as inflationary pressures whilst ensuring that the benefits of the projects are translated into socio-economic benefits for the country as a whole. To manage the expected windfall revenue, the Government is currently exploring options to set up three interrelated funds. These are: a stabilization fund (using revenue streams from 30.0 per cent corporate tax and additional profit tax), an infrastructure fund (using dividends from the state's equity stake held by Kroton No. 2) and a future fund (using portions of revenues from the 30.0 per cent corporate tax, additional profits tax and dividends from the LNG project). The Umbrella Benefit Sharing Agreement (UBSA) and License Based Benefit Sharing Agreement (LBBSA) state the benefits that will accrue to the landowners in the affected areas.

A second LNG project has also been considered by the Government in Gulf Province, a US\$6.0 billion venture with shareholdings from InterOil Corporation, Merrill Lynch Commodities, Pacific LNG Operations and Petromin (State Nominee). The Project is expected to last for 25 years, following construction in 2011 for 3-4 years. The proposed project will have an underground gas pipeline from the two fields down to the coast between Kerema and Ihu, before reaching land at the proposed processing plant near Napa Napa InterOil refinery. For the Gulf LNG project, the local work force is expected to peak at 1,700 with local companies securing almost K2.0 billion in contracts. The annual direct contribution to PNG's GDP is estimated to peak at K3.5 billion (in constant, 2006 prices) and payments to Government are estimated as K6.4 billion in Net Present Value (NPV) terms.

Recent agreements for the sale of gas with China and Japan, coupled with the high demand in the Asian markets, indicate the potential for PNG to benefit from the gas sector. Moreover, the Government's focus on on-shore downstream processing of natural gas into processed petrochemical products, including LPG, will add added value to the sector. It is Government's ambition to have at least three LNG projects by 2015, producing and exporting 6.3 million tonnes and an increased number of petroleum licenses over the period, from 75 to 80, as detailed in the MTDP. The Government is also encouraging the exploration of oil and gas across the country.

In 2011, the Government will meet state commitments associated with the LNG project. This includes payment of the K120.0 million Infrastructure Development Grant under the UBSA commitment and contributions towards the High Impact Infrastructure Projects in Southern Highlands Province (K100.0 million).

9.2.6 Mining Sector

PNG experienced a proliferation in the number of mining projects during the 1970s and 1980s due to extensive copper and silver deposits, and the third-largest gold reserves in the world. The rate of new mines opening has fallen in recent years, however, the mining sector continues to be major export earner for the country, boosted by high commodity prices. Under the DSP, the goal for the sector is to double mineral exports, whilst minimizing the

adverse impact on the environment. To reach this objective, the Government hopes to increase the number of exploration licenses to 250 and the number of operational mine sites to 12 over the MTDP period (2011-2015).

The sector is guided by the Mineral Resources Authority (MRA), established in 2005, and the Department of Mineral Policy and Geohazards Management. Fiscal incentives, the evolution of an enabling policy and regulatory environment and high commodity prices have provided sufficient incentives for developers to invest in the mining industry. As of June 2010, the Chamber of Mines records indicate 181 current exploration (EL) licenses, 127 license renewals and 158 applications for 2010. The number of applications has increased from the number recorded in 2009 (104).

There are currently seven mines in operation, which includes: Tolukuma, Ok Tedi Mining Ltd, Porgera Joint Venture Ltd, Simberi Gold Company Ltd, Ramu Nickel, Lihir Gold, Mt. Sinivit Ltd and Hidden Valley. The first gold pour from Hidden Valley was in June 2009 and it was officially opened in September 2010. Production at Ramu Nickel, Madang province was scheduled to start in the December quarter of 2010. However due to a court injunction on the disposal of waste tailing, production has been delayed. About 90.0 per cent of the mine has been constructed by Metallurgical Chinese Corporation and once the DSPT pipeline has been completed, production is expected to begin in the June quarter of 2011. Once production has started, Ramu Nickel is projected to produce 31,500 tonnes of nickel and 3,300 tonnes of cobalt per annum, over a twenty year lifespan.

Ok Tedi Mine was scheduled to cease operation in 2013, followed by Porgera in the near future. However a feasibility study is currently looking into extending Ok Tedi mine for another seven years. Production will however be at half the level of current outputs.

A number of new mines are at exploration stage. These mines will further develop the minerals sector and increase export earnings for PNG. Yandera is currently completing its definitive feasibility study whilst Frieda river project completed its pre-feasibility study in September 2010. Yandera is projected to commence production in 2013, whilst Frieda is expected to commence mining activities in 2016. Advanced exploration of the Wafi-Golpu and Woodlark Projects is currently underway with the potential to be developed into mines in the near future, whilst the Tabar project is in still being investigated.

In addition, Government has issued the world's first off-shore exploration license to Nautilus Minerals Ltd to mine Seafloor Massive Sulphides (SMS) deposits, copper, gold, zinc and silver in the Bismarck Sea. Under the Solwara 1 project, Nautilus Minerals Ltd, in conjunction with Jan De Nul, will commercially explore the seafloor at a depth of 1000m. The capital cost is estimated to be K1.6 billion and the average operating cost is expected to be K291.0 per tonne based on a production rate of 1.35 million tonnes annually. Over the project life, the value added to the PNG economy is estimated to be K164.0 million. An Environment Impact Assessment and feasibility study were carried out in 2008 and Nautilus Minerals are currently awaiting issuance of a mining lease to commence construction. Production is expected to commence in 2012.

In recent years the disposal of mine waste has been an issue for PNG, exemplified by the recently reported mining waste sea tailing by Ramu Nickel, the Ok Tedi Mining Ltd court case and accusations leveled against Tolukuma gold mine for disposing mine waste into the Angabanga River. It is the Government's responsibility to protect the environment, ensure landowners and all stakeholders benefit and provide a regulatory and policy framework for the mining sector that is both simple but effective to keep industry compliance costs to

minimum. The *Mining Regulation 1992* and Mineral Resources Party Ltd 1996, succinctly delineates the regulatory framework that should be complied with by the mining companies in their investments. The Department of Environment and Conservation (DEC) further supports the mining sector through conducting Environmental Impact Assessments and the invoking of the *Environmental Planning Act, 1978*, the *Environmental Containments Act, 1978* and the *Water Resources Act, 1982*. In 2011, the Government will continue to support DEC to perform its mandated responsibility.

Effective mine closure is also an issue that the sector faces. Lack of a coherent mine closure plan can result in project impacted communities losing out on long term benefits once the developer completes and leaves the project. The Government's generic Mine Closure Planning Structure, prepared by DMPGM should help communities prepare for timely and orderly closure of mines in the near future.

The benefits accruing to the Landowners, Provincial Governments and Local Level Governments of the mine impacted areas has been an issue of contention for a number of years. Concern around the use of MoAs, royalties and Special Support Grants (SSGs) by Landowner Associations and Provincial Governments remains and the benefits of substantial revenue is not being realized on the ground in the form of improved health, education and transport infrastructure. In 2011, payments will be made to honour the commitments made through budgeting of a projected K66.7 million in SSG payments and K32.1 million in MOA commitments. The sector will also be supported by institutional strengthening projects from EU grant funding and World Bank loan financing.

9.2.7 Manufacturing

The manufacturing sector has the potential to transform PNG's economic base. The sector currently contributes 0.5 per cent of real GDP. Processing industries for natural resources to finished products dominate the manufacturing sector such as canned tuna, furniture, biofuel, refined petroleum, refined palm oil, canned meat, fabricated metal projects, plywood and veneer. As such, the manufacturing sector relies heavily on agricultural and resource based industries. About 70.0 per cent of the manufacturing sector is located in Port Moresby, Lae and Madang.

Foreign equity holdings in the sector increased by 79.0 per cent between 2004 and 2005 and held consistently until 2009. Between 2003 and 2006, 95.0 per cent of investment approvals were granted to foreign companies to conduct manufacturing businesses. Overseas investors in PNG are predominately Australian, Taiwanese, Singaporean and Malaysian. The total investment proposed by these firms was K334.0 million, with 3,648 new job opportunities generated in East New Britain, East Sepik and NCD. In 2009 the manufacturing sector contributed 8.4 per cent of total foreign equity holdings but this figure was projected to decline throughout 2009 and 2010.

The development of the manufacturing sector is guided by different policies of Government, through the Department of Commerce and Industry, Chamber of Commerce and Industry, key state-owned enterprises and the Industrial Centres Development Corporation. Under the leadership of these agencies, the government aims to reduce impediments to business and investment and advance the sector from the downstream processing of primary commodities to the development of higher value production chains and appropriate technologies. Direct interventions to this effect include the lowering of input tariffs, overburdening regulatory constraints and export duties, whilst the creation of an enabling environment through

investment in addressing the law and order situation, deteriorating transport infrastructure, land reform and provision of key utilities also reduces the cost of business in PNG. Over the DSP period, the Government is committed to tripling the value of manufacturing production, the level of exports and current investment in the sector.

The Government is also committed to assisting the manufacturing sector through facilitating the development of Small Medium Enterprises (SMEs). For instance, through the Small Business Development Corporation (SBDC), in conjunction with relevant schools and NGOs, the Government is providing training courses to improve SMEs' development into the manufacturing sector. Other initiatives that will increase the revenue and the growth of the sector are the petro chemical processing and exporting plants associated with the LNG project. This includes the Juha Production Facility due to be established in 2020, the Hides Gas Conditioning Plant, Kutubu Central Processing Facility and Gobe Production Facility.

In 2011, to support the manufacturing sector the Government through the Development Budget will be financing SMEs appropriate technology development programme, leather manufacturing capacity development programme and the know about business project to the value of K10.0 million.

9.3 CROSS-CUTTING

9.3.1 Environment

PNG is one of the most bio-diverse countries in the world. However, balancing economic development with biodiversity conservation and environmental sustainability remains a challenge for the country. About 85.0 per cent of the population live in the rural areas and depend on natural resources for their livelihoods, such as those in the fisheries, forestry, and agricultural sectors. However, in the pursuit of economic prosperity these sectors have been compromised by unsustainable development practices.

The Department of Environment and Conservation (DEC) is the mandated Government agency responsible for protection of the environment, including air, water, soil, biodiversity and the sustainable use of natural resources as detailed in the fourth goal of the National Constitution. This includes maritime exploration, water resource management and environmental monitoring of mines, fisheries, forestry and oil and gas fields. DEC's mission statement is to ensure the country's natural resources are managed to sustain environmental quality, support human well being and improve standards of living. Furthermore, as part of the Department of Environment and Conservation's (DEC) reform, DEC is developing a framework to establish an Environment Protection Authority (EPA). The proposed EPA will help ensure the needs of future generations are not compromised amid challenges of unsustainable logging operations, direct disposal of industrial waste, mangrove depletion, unsustainable fishing practices and climate change.

To further support the environment sector, the Office of Climate Change and Development (OCCD) was created in March 2010. The OCCD is the successor to the former Office of Climate Change and Environmental Sustainability (OCCES) which was abolished under NEC decision 53/2010. PNG is particularly vulnerable to the effects of climate change and investment in mitigation and adaptation measures are required. As such, the core responsibilities of the OCCD include: policy development, coordination between agencies and stakeholders to implement climate change programs/projects, securing of international funding, compliance with international climate change regulations, national awareness on climate change issues and capacity building.

OCCD, in collaboration with stakeholders, is finalizing the Climate Compatible Development Strategy (CCDS). The CCDS details the Government's climate change mitigation strategies, including REDD+, adaptation efforts and interventions to ensure PNG continues on a path of low carbon growth.

The United Nations Climate Change conference of the Parties 15 (COP 15) in Copenhagen in December 2009 lead to the Copenhagen Accord in which developed countries committed over US\$30.0 billion to assist developing countries adapt to and mitigate the effects of climate change. The Office of Climate Change and Development (OCCD) will be responsible for securing funds for PNG and utilizing them in adaptation and mitigation interventions.

The environment sector is guided by the three Rio Environment Conventions, the *Environment Act 2000* and 45 regulations, acts and policies guiding compliance, enforcement and adherence to standards. Furthermore, the Government is a signatory of the MDGs, of which MDG 7 aims to ensure environmental sustainability by integrating the principles of sustainable development into country policies and programs and to reverse the loss of environmental resources by 2015. Since 2000, little, if any, progress has been made towards achieving MDG 7. However, the global and national targets for MDG 7 remain vague and imprecise, rendering measurement of progress difficult to ascertain. Moreover, the lack of complete and reliable data makes it difficult to establish a reliable trend for any of the indicators with much confidence. A coordinated approach in the collection, analysis, storage and dissemination of environmental data to monitor progress and inform policy decisions is urgently required.

Nonetheless, to increase progress towards the MDG 7 national targets by 2015, the Government will work towards ensuring 59.0 per cent of land continues to be covered by primary forests, the depletion rate of primary forest is reduced from 2.6 per cent to 2.4 per cent and the land area protected to maintain and improve biological diversity is increased from 3.8 per cent to 4.0 per cent.

In 2011, the Government will provide support to the environment sector in the Development Budget through financing of the Owen Stanley Brown River Catchment and marine program on coral reefs, fisheries and food security. Development Partners are also investing in various elements of environmental sustainability, such as waste management (JICA) and environmental management and sustainable livelihoods (UN).

9.3.2 HIV/AIDS

HIV/AIDS is a development issue which cuts across all sectors of the economy. Unless it is adequately addressed, HIV/AIDS has the potential to significantly undermine the social and economic progress in PNG.

The most recently published statistics conducted by the National Department of Health (NDOH) and the National AIDS Council Secretariat (NACS) estimates the prevalence of HIV among adults aged 15-49 years to be 0.9 per cent. This is 0.2 per cent lower than the estimate detailed in the 2008 UNGASS Country Progress Report. HIV prevalence is highest in the Highlands and Southern Region (1.02 per cent and 1.17 per cent respectively) with lower estimates in the Momase and New Guinea Islands (0.63 per cent and 0.61 per cent respectively). The number of clinics providing voluntary counselling and testing services throughout the country has increased ten-fold, from 17 in 2005 to 178 in 2009. This has provided a much more comprehensive set of information to draw from.

The *PNG HIV prevalence: 2009* estimates further reports the total estimated number of people living with HIV to be 34,100 (31,000 adults and 3,100 children), and the number of newly infected people to be 3,200. In 2009, the total number of deaths from HIV related illnesses and AIDS was estimated to be 1,300, however access to prevention and treatment services was noted to have improved in recent years. There is still a need to scale up efforts in a sustained manner. However, the lack of reliable data makes it difficult to assess the situation accurately. It is possible that the number of infections is higher or increasing more rapidly than current estimates suggest as testing has become *voluntary* instead of *compulsory*, as in the recent past.

In 2011, the Government's effort to combat the HIV/AIDS epidemic will be guided by the new National HIV and AIDS strategy (NHS) 2011-2015. This strategy focuses on: a comprehensive prevention strategy, a sustainable care, treatment, testing and counselling strategy and improved organisational capacity and system strengthening. These strategies will ensure the Government meets the HIV/AIDS targets set out in the MTDP. These include reducing the prevalence rate of HIV/AIDS to below 0.9 by 2015, reducing the number of orphan children due to HIV/AIDS from an estimated 5995 to 4000 and increasing the per cent of HIV-positive pregnant women receiving ART from 3.5 per cent to 20.0 per cent. These targets will help ensure the Government meets its commitment to achieve MDG 6: combat HIV/AIDS, malaria and other diseases.

To further support implementation of the strategy, additional guiding policies include: the *National Research Agenda 2008-2013* directing HIV/AIDS behavioural research, the *National Prevention Strategy (NPS 2011-2015)*, the *Out of School Youth Sexual Reproductive Health and HIV & AIDS Manual* and the *National Leadership Strategy 2011 to 2015* (NSL) will guide the NHS priority area of institutional strengthening.

Efforts to combat the HIV and AIDS epidemic will be led by the National AIDS Council Secretariat in collaboration with the National Expenditure & Fiscal Commission (NEFC), DPLLGA and PLLSMA integrating HIV & AIDS priorities into sub-national level service delivery functions and responsibilities. NACS will continue with monitoring and surveillance work in collaboration with National Department of Health, through the National Health Information System which captures data from regionalized Voluntary Counseling and Testing Centres (VCTCs) and Sero-surveillance sites in selected anti natal clinics. In 2011, NACS will also continue the National Anti Retroviral Therapy Program through accredited sites throughout the country.

Over the past five years, the Government and Development Partners have increased funding to the national HIV/AIDS response. Annual funding has supported over sixty different stakeholders including: 20 Provincial AIDS Committee Secretariat (PACS), national and international NGOs, faith based organizations (FBOs), People Living with HIV (PLHIV) Organizations, the business sector communities and government departments and agencies. In 2011, the Government has appropriated K20.0 million in the Development Budget to ensure effective implementation of the NHS. This is an increase of 72.0 per cent from the 2010 appropriation (K11.6 million). The provision of Anti-Retro Therapy has been appropriated for in the Recurrent Budget (K15.0 million). Development Partners continue to support efforts to stem the epidemic, to the value of K148.7 million in 2011.

CHAPTER 10. MEDIUM TERM DEBT STRATEGY

10.1 OVERVIEW

10.1.1 Objective and Context

The objective of the Medium Term Debt Strategy 2011–2015 (Debt Strategy) is to minimize the cost of debt consistent with the Government's tolerance for financial risk. There are three major strategies: (i) maintain debt at sustainable levels; (ii) change the composition of the debt portfolio so as to maintain financial risk at prudent levels; and (iii) develop the domestic debt market. The Debt Strategy is aligned to the Medium Term Fiscal Strategy and Development Strategic Plan.

The Debt Strategy covers debt issued by the State and secured by a claim against consolidated revenue (Central Government debt). It does not cover the management of the debt of State Owned Enterprises and other contingent exposures. However, these general State liabilities were considered in the formulation of this strategy.

Over the last five years, the Government has made excellent progress in implementing the Debt Strategy by reducing Central Government debt, particularly foreign currency debt, to prudent levels. However, this has been offset by an increase in off-balance sheet foreign currency liabilities. Due to the high level of State liabilities, maintaining debt at prudent levels and managing financial risks remain important objectives of this Strategy.

10.1.2 The Updated Debt Strategy

The Debt Strategy has been updated for the financial and macroeconomic forecasts in the 2011 Budget and Medium Term Fiscal Strategy (2008-2012). There are also several changes from the previous Debt Strategy and these include:

- Previously the strategy focused on reducing the level of debt, in particular foreign currency debt. This has brought the debt to GDP ratio to below 30.0 per cent and foreign currency debt to 40.0 per cent of the portfolio.
- The strategy now aims to keep debt to GDP at or below 30.0 per cent consistent with the Development Strategic Plan.
- The strategy also aims to have foreign currency debt at 40.0 per cent of the portfolio, however recognizes that there may be times when this percentage will vary as borrowing can be lumpy due to large-scale investment projects.
- Circumvention of budget and debt controls by proponents of public-sector capital expenditure funded by foreign-currency debt remains a threat to this strategy.

10.2 MAINTAINING DEBT AT SUSTAINABLE LEVELS

PNG's debt sustainability will be improved through four major means: (i) the growth in the economy; (ii) improvements in public sector management and governance; (iii) prudent

management of public debt, other liabilities and assets; and (iv) reducing reliance on high-risk, complex debt and increasing reliance on low-risk, simple debt securities.

The most widely accepted and used measure of debt sustainability for a State is its sovereign credit rating. The State has a foreign currency debt rating of B plus. This means that the rating agencies believe PNG is vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments. One of the factors that prevented an improvement in the rating was an increase use of off-budget borrowing and expenditure.

All State liabilities will impact the sustainability of the Government's debt. State liabilities in addition to Central Government debt include the Independent Public Business Corporation's borrowing to fund its share of the PNG LNG project of AUD1.7 billion (K4.3 billion) and the State's share of the PNG LNG project debt (K5.3 billion) which is guaranteed by the State until the project construction reaches completion. Through these liabilities, the State's finances are heavily exposed to the success of the PNG LNG project. In addition, the State has unfunded public service superannuation liabilities of K1.9 billion.

Treasury analysis indicates that due to the high level of State liabilities, further significant increases in debt would be imprudent. Therefore, the Government aims to keep Central Government debt at or below 30.0 per cent of GDP. In the event that debt increases above this level the Government will use budget surpluses and windfall revenue to reduce its liabilities.

10.3 REDUCING FINANCIAL RISKS

Treasury aims to minimize the cost of debt and keep the risk of debt at tolerable levels through competitive auction of simple financial securities denominated in Kina and borrowing limited amounts of highly concessional debt from international financial institutions or other development partners.

Treasury's analysis indicates that complex financial instruments and opaque off-balance sheet structures are inappropriate for PNG due to lack of skills, technology and systems. The international financial crisis has also provided strong support for a "keep it simple strategy" with large international financial institutions failing to manage the risks of complex financial instruments and off-balance sheet structures.

10.3.1 Foreign Currency Risk

The level of Central Government external debt has been reduced from 40.0 per cent of GDP in 2002 to around 11.0 per cent in 2010. However, this has been offset by an increase in foreign currency denominated off-balance sheet liabilities related to the PNG LNG project. Central Government external debt plus Independent Public Business Cooperation's borrowing for the State's equity share in the PNG LNG project and the State's guarantee of the project debt total 53.0 per cent of GDP. Managing the level of foreign currency risk therefore remains an important objective of this strategy.

The Government aims to maintain foreign currency debt at around 40.0 per cent of the total Central Government debt portfolio by restricting the amount of new foreign currency loans it enters into. In addition, where it is appropriate on a risk/return basis, the Government may borrow domestic funds to retire foreign-currency debt.

New foreign -currency loans will still be considered if:

- (i) The loan is highly concessional and in a low risk currency. The criteria for considering concessional financing shall be a grant element of 35.0 per cent or more. This is in line with international debt management practice and as recommended by the IMF and the World Bank.
- (ii) A project is a high priority under the Medium Term Development Plan and will not significantly increase the level of external debt above 40.0 per cent of the total debt portfolio or increase the level of Central Government debt above 30.0 per cent of GDP.
- (iii) The lender's policies do not preclude awarding of contracts to PNG firms and/or awarding of contracts via international competitive bidding.
- (iv) There is a genuine advantage to funding the project from foreign currency loans such as the need to import foreign expertise and/or foreign materials.

In 2011, it is expected that foreign currency debt will increase slightly above the target mix of 40.0 per cent of total debt to 43.0 per cent. This is mainly due to the commencement of capital works on several large-scale infrastructure projects.

10.3.2 Interest Rate Risk

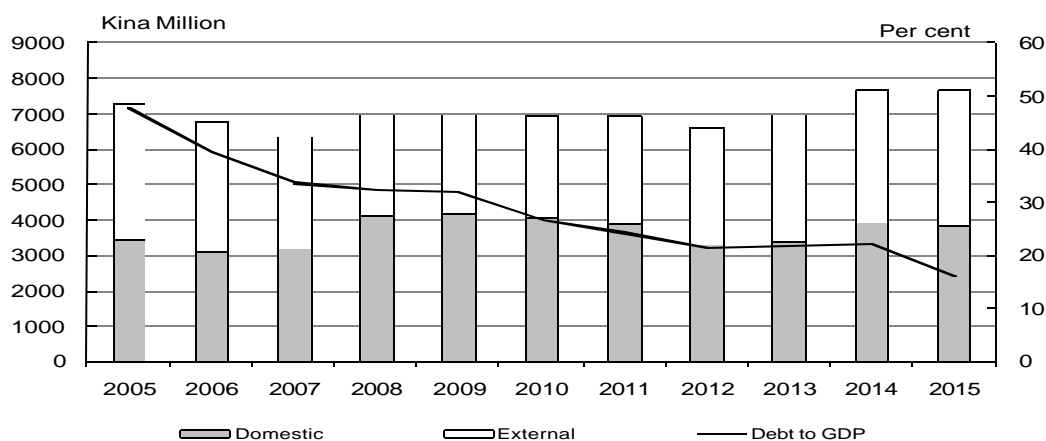
The Debt Strategy aims to increase the net amount of fixed-rate Inscribed Stock by K0.2 billion over the next five years, and decrease Treasury Bills from about K1.5 billion as at the end of 2010 to about K0.5 billion in 2015.

The current level of Treasury Bills is around 36.0 per cent of the domestic portfolio. The Government aims to reduce Treasury Bills to be in the range of 15.0 to 30.0 per cent over the next year.

Table 56: Approximate Composition of Domestic Debt by Instrument

Instrument Type	Current (end 2010) Per cent	Target Range Per cent
Treasury Bills	36	15-30
Inscribed Stock	64	70-85

Source: Department of Treasury

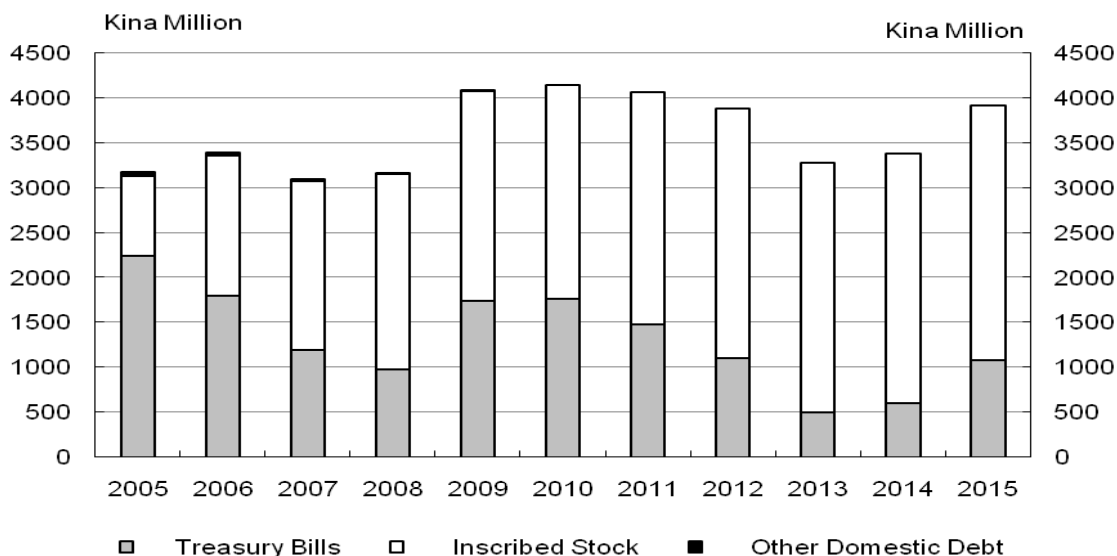
Figure 38: Currency Composition of Government Debt 2004 - 2014 (Kina Millions)

Sources: Department of Treasury

10.3.2 Refinancing Risk

The Debt Strategy will maintain the average maturity at about 5 years for the domestic debt portfolio, and an average maturity at about 8 years for foreign-currency debt.

Treasury has reviewed its targets for the use of long-term fixed-rate debt relative to short-term variable-rate debt, and plans to increase Inscribed Stock from K2.6 billion at the end of 2010 to K2.8 billion in 2015, while maintaining the maximum maturity of Inscribed Stock at 17 years, and limiting the amount of Inscribed Stock maturing in any one year to K500.0 million.

Figure 39: Composition of Domestic Debt 2004 - 2014 (Kina Millions)

Source: Department of Treasury

10.3.3 Operational Risk

Operational risk is defined by the Bank of International Settlements as risk of losses resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk.

The operational risks facing Treasury include the difficulty in developing and retaining skilled staff, the lack of a business continuity plan, and a heavy dependence on few key personnel operating the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS). Treasury mitigates these operational risks through a capacity development plan, and by working in partnership with the Commonwealth Secretariat and other CSDRMS users.

10.4 LONGER-TERM IMPROVEMENTS

Treasury will also continue with incremental improvements in monitoring, reviewing and updating the Debt Strategy annually to reflect international and domestic developments relevant to PNG. Significant challenges for improving debt sustainability and management of financial risks still remain. These include:

- A small domestic investor base and lack of foreign investors in Kina denominated securities;
- Increases in contingent liabilities such as the IPBC's borrowing to invest in the PNG LNG Joint Venture;
- The impact that the PNG LNG project will have on the size of the economy, the exchange rate and domestic financial markets; and
- Lack of coordinated management of the State's financial assets and liabilities.

The long-term strategies to address these challenges include:

- (i) Development of liquid primary and secondary markets in Kina-denominated Inscribed Stock, Bills and Loans.
- (ii) Developing a Whole-of-Government Balance Sheet Framework (WOGBS) based on asset-liability management principles. Work on the framework commenced in 2009. The WOGBS will enable the Government to manage the volatility of the State's net worth and other contingent exposures. Implementation will be complex and takes time as it will involve participation by other public sector entities responsible for managing financial asset, liabilities and exposures.

CHAPTER 11. UPDATE TO ECONOMIC AND FISCAL IMPACT OF PNG LNG

11.1 OVERVIEW

This section provides an analysis of the potential impact of the PNG LNG project on the PNG economy, following the decision by project partners to fully execute the project after financing and sales arrangements were finalized in March 2010. The analysis updates earlier projections published in the 2009 Budget based on the latest available data, and some refinements to the methodology and assumptions.

The PNG LNG project, undertaken by an Exxon Mobil led joint venture is the largest project undertaken in PNG. The project is an integrated development that includes gas production and processing facilities in the Southern Highlands and Western Provinces of Papua New Guinea, including liquefaction and storage facilities (located northwest of Port Moresby on the Gulf of Papua) with capacity of 6.6 million tons per year. There will be over 700 kilometers (450 miles) of pipelines connecting the facilities.

The investment for the initial phase of the Project, excluding shipping costs, is estimated at US\$15.0 billion. Employment in the project is expected to peak during the four year construction phase at approximately 12,000 workers, about one third of whom are expected to be Papua New Guinean citizens.

Over the life of the Project, PNG LNG is expected to produce over nine trillion cubic feet of gas and 200 million barrels of associated liquids. First LNG deliveries are scheduled to begin in 2014 supplying four major LNG customers in the Asia Pacific region through long-term sales.

11.2 THE DIRECT IMPACT ON THE PNG ECONOMY

The PNG LNG project will be the largest and most expensive investment in PNG to date; however, the extent of the impact on Gross Domestic Product (GDP) depends on how much of the economic activity actually occurs in PNG. Much of the project construction material will take place offshore, which does not add to the size of the domestic economy.

The construction phase of the project covers field development, pipeline and PNG liquefaction plant, storage and load out. In this phase, it is assumed that all of the capital expenditure occurs offshore, and 90.0 per cent of the labour costs will be for foreign labour, with 10.0 per cent for domestic labour. While overall construction cost of the project will see direct activity of US\$15.0 billion, only 4.5 per cent, or around US\$675.0 million is expected to directly affect the PNG economy over the construction period.¹⁰

Similarly, much of the annual operating expenditure will be sourced from offshore, with an estimated 95.0 per cent of the non-labour costs imported, and an average of around 15 per cent of the labour costs relating to foreign labour. The domestic share of economic

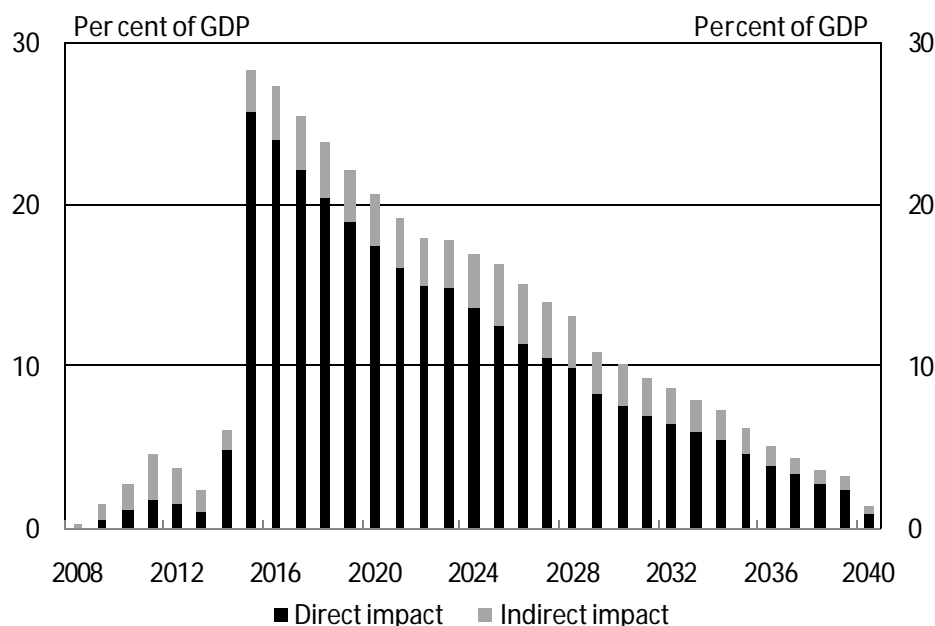
¹⁰ This includes only PNG produced goods and services produced onshore; onshore spending on imported goods is largely excluded in this figure.

activity relating to operations and maintenance is estimated at around 21.0 per cent, translating to around US\$40.0 million per year.

In all, the direct economic impact on GDP in PNG is expected to be relatively small during the construction phase. This is because most of the expenditure will take place offshore, or will be paid to foreign labour, who are assumed to spend only 10.0 per cent of their income within PNG.

The major economic impact from the PNG LNG project will be felt in the first year of full production, which is expected to be 2015, providing a very large boost to GDP. Once production begins, the direct impact on GDP will be very large, as all of the value added from the project is recorded as taking place in PNG. Over the length of the project, annual gross value added is estimated to average around K2.0 billion in real terms. Over the peak production phase, this represents an additional 20.0 to 25.0 per cent of GDP per year, although the relative impact is expected to decline over time as the economy increases in size and as production declines towards the end of the project's life (Figure 40).

Figure 40: Direct and Indirect Impact on Real GDP

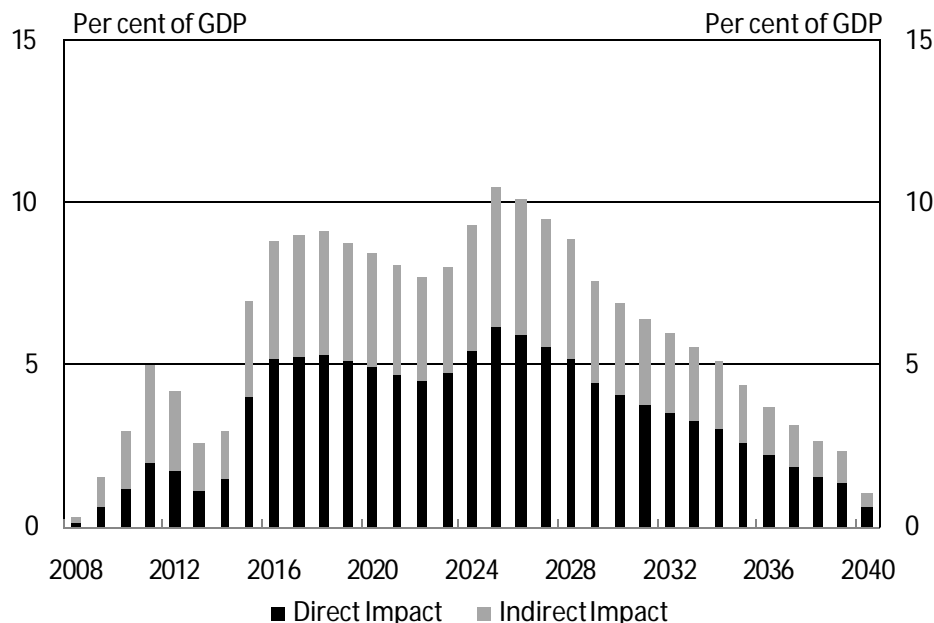


Note: Comparison is against baseline real GDP. This is the estimated level of GDP in the absence of the PNG LNG project.
Source: Department of Treasury

However, when estimating the economic impact of major investment projects in PNG, it is important to draw the distinction between production and income. This is because most of the gross operating surplus will be repatriated offshore, in the form of dividends or interest repayments on debt. These income outflows will not have any major economic impact within PNG. The income remaining onshore will include tax payments, which make up the bulk of the impact, dividend payments to PNG residents, royalty and development levy payments to landowners and provinces, as well as income earned by local employees and contractors. While it is usually more useful to examine production in real terms, so as to abstract from changes in prices, when analyzing income, the nominal impact (which includes both price and volume changes over time) is more relevant. Therefore the impact on Gross National Income (GNI) is stated in nominal terms.

Figure 41 shows that the most significant increase to GNI is expected to occur with the production and sale of LNG in 2015, with the impact on GNI peaking at around 11.0 per cent of baseline nominal GDP in 2025. During the first ten years of production, there is projected to be a higher outflow of income due to the repayment of principal and interest on debt. From 2023 onwards, the GNI profile increases, reflecting the fall in interest payments as project debt declines and tax concessions are exhausted. However, from 2025 the profile declines again due to revenue growing more slowly than GDP growth and as production of LNG declines.

Figure 41 : Direct and Indirect Impact on Nominal GNI



Note: Comparison is against baseline nominal GDP. This is the estimated level of GDP in the absence of the PNG LNG project.
Source: Department of Treasury

11.3 THE INDIRECT IMPACT ON THE PNG ECONOMY

The methodology employed by ACIL Tasman has been used to estimate the indirect impact of the project on economic activity in PNG. The indirect impact reflects the flow-on effects of higher government expenditure on the broader economy, additional domestic expenditure from foreign workers and increased business and consumption activity generally. Applying a multiplier of 0.7 to the direct impact on GNI provides an estimate of around K450 million annually in real terms of additional activity over the life of the project. In addition, during the construction period, when there are large numbers of expatriate employees working in PNG, their local expenditure (assumed at 10 per cent of their incomes) is anticipated to add to indirect activity – in the range of K100 to 200 million per annum in real terms during the peak of the construction phase.

These indirect impacts are likely to come from a number of sources, including increased business activity from local companies that supply goods and services to the mining project and its employees, increased activity relating to higher Government expenditures, as well as increased domestic activity from unrelated activities, such as agriculture, that experience higher aggregate demand and possibly improved access to markets.

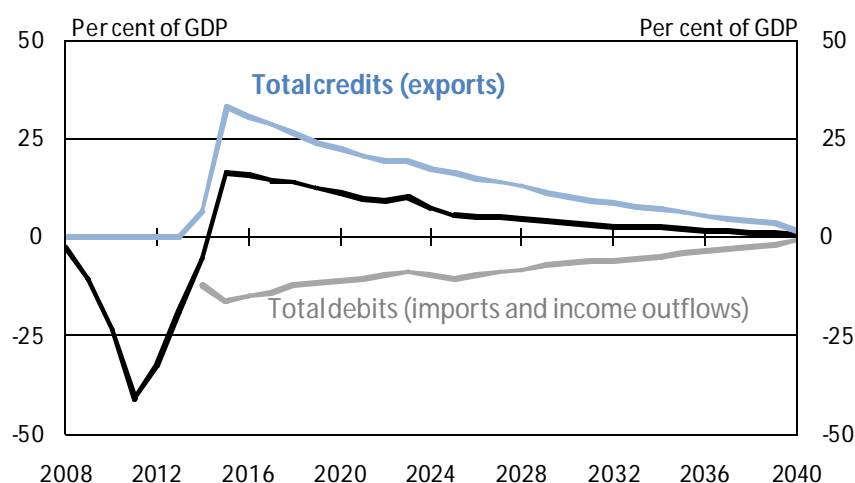
The project's total impact on the economy is the sum of the direct and indirect impacts. The total impact on real GDP is estimated to average around K3 billion to K3.5 billion in real terms (an increase of around 25 to 30 per cent) over the peak production phase of the project, and average around K2 billion to K2.5 billion per annum in real terms over the life of the project.

While the total impact of the project on nominal GNI, which provides a more representative picture of the economic impact of the project, once overseas flows are removed, is around K7 billion per annum in nominal terms or 6 per cent of nominal GDP.

11.4 THE IMPACT ON THE BALANCE OF PAYMENTS

The PNG LNG project is also anticipated to have an extremely large impact on PNG's balance of payments. During the initial construction phase, large amounts of imports and income payments can be expected to result in exceptionally large current account deficits (Figure 42). Once construction is completed, and production begins, the increases in exports are expected to move the current account into surplus, although this will be partially offset by increased income outflows, as interest and dividend payments flow offshore.

Figure 42: Impact on Current Account Balance



Note: Comparison is against baseline nominal GDP. This is the estimated level of GDP in the absence of the PNG LNG project.
Source: Department of Treasury

The majority of construction activity is anticipated to be imported directly from overseas, or built and assembled within PNG by foreign residents on short term visits. The construction materials, worth approximately, K22 billion, will be recorded as imports of goods and services, while payments to expatriate employees temporarily residing in PNG, worth approximately K18 billion, will be recorded as compensation of employees in the income account (although some may fall under service imports). These imports and income payments will result in an extremely large current account deficit.

As the project moves into the production phase, exports of LNG, condensate and LPG are expected to be worth K13 billion to K14 billion annually. Partially offsetting this will be imports of goods and services and payments made to foreign workers of around K1 billion to K1.5 billion per annum, resulting in a large trade surplus.

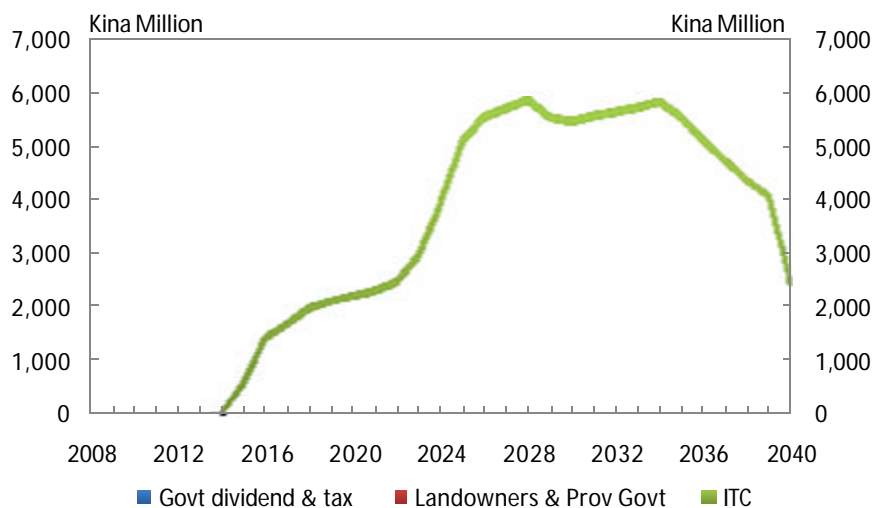
However, under current accounting rules, there will also be significant income outflows in the form of interest expenses, dividend payments and reinvested income (if the profits are not paid out as dividends).¹¹ This will result in a large income deficit, which will initially offset the trade surplus coming from LNG exports, before declining once taxable depreciation write offs and elevated interest expense end approximately 12 years after production begins.

11.5 REVENUE IMPACT AND DISTRIBUTION OF BENEFITS

The major benefit of the PNG LNG project to the National Government, provincial governments and landowners is from distributions of company tax (reported as mining and petroleum tax revenue or MPT), mining royalties (including the development levy) and dividends on equity. A small portion of company tax will be paid indirectly through the Infrastructure Tax Credit Scheme.

Treasury has made its own assumptions in estimating the flow of revenue receipts. As such, this analysis should be regarded as providing indicative estimates only. The most significant of these assumptions relate to LNG pricing and PNG LNG's dividend policy (which is assumed to distribute all of its annual after-tax profit to shareholders with a six month lag). Estimates are also based on the assumption that landowners take up their full entitlement to purchase additional equity in the project of 4.1 per cent. It has been assumed that the major equity partners (Exxon Mobil and Oil Search etc) are non-resident entities and hence the associated dividends are paid offshore.

Figure 43: Distribution of Annual Revenue within PNG



Source: Department of Treasury

Figure 43 shows the estimated annual distribution of revenue to the National Government from MPT and dividends and to provincial governments and landowners (from mining royalties and dividends). It also shows annual non-cash payments through the infrastructure tax credit program. Of the revenue paid to the National Government, around three-quarters

¹¹ The balance of payment accounting treatment is based on the framework set out by the IMF, and may not necessarily be consistent with the cash flow treatment.

is paid as MPT revenue over the life of the project, with the remainder paid as dividends to Kroton No. 2 and Petromin.

Government revenue is expected to increase rapidly during the first 10 years of production, as the benefits of accelerated depreciation (a form of tax concession) are gradually exhausted. Lower tax payments in the first ten years provide the project with additional retained earnings, which are assumed to repay project debt (this assumption also contributes to greater dividend stability). Revenue is then expected to be relatively stable until production starts to decline later in the life of the project.

Total National Government revenue to 2040 is estimated at about US\$31 billion, which is 64 per cent higher than the 2009 Budget estimate of US\$19 billion over the same period, largely due to higher price assumptions compared to the earlier analysis.

Based on Treasury assumptions, total receipts from PNG LNG (received between 2014 and 2040) are distributed as follows. Around one-third is paid overseas in costs (particularly capital costs and interest payments), around one-third is paid overseas as dividends, and around one-third remains in PNG. Of the amount of revenue that remains in PNG, the vast majority is paid as tax revenue, dividends, royalties and infrastructure tax credits to the National Government, provincial governments and landowners, with around 10 per cent paid as operational costs.

This analysis reflects the current status of the PNG LNG project. Accordingly, it does not account for the possibility of an additional LNG train for the PNG LNG project, which is being contemplated. In addition, it does not capture the economic and fiscal impact of the prospective second LNG project in PNG led by InterOil, which would also be significant.

CHAPTER 12. THE ESTABLISHMENT OF A SOVEREIGN WEALTH FUND

12.1 OVERVIEW

The development of the Papua New Guinea Liquefied Natural Gas Project (PNG LNG project), and the prospect of others, has the potential to transform PNG's economy and substantially improve the standard of living of all Papua New Guineans. However, it is likely that the emergence of LNG as a major revenue source will give rise to macroeconomic pressures including the effects of Dutch Disease, which are more likely to be prevalent when a country relies heavily on commodity based revenues.

In light of these likely economic implications from LNG production, the Department of Treasury sought to initiate public consideration of these issues by providing a comprehensive discussion in the 2010 Budget. As a consequence of this discussion and separate advice to Government, the Department of Treasury prepared a submission to NEC on an offshore sovereign wealth fund and obtained Government agreement to the establishment of a joint Treasury – Bank of Papua New Guinea Working Group to consider alternative arrangements to help manage the significant revenues arising from this project to be used for PNG's development needs whilst promoting macroeconomic stability.

Following NEC agreement to Treasury's submission in March 2010, the Working Group was established mainly to canvass possible options for Government consideration, including the possible creation of an offshore fund to manage windfall revenues arising from the PNG LNG project.

In undertaking this work, the Working Group consulted with, and sought input from, PNG Government agencies and relevant domestic and international stakeholders including the IMF, World Bank, ADB and AusAID. Two significant workshops were also conducted in Port Moresby to gather views from the domestic and international stakeholders during the month of May 2010. The overall response from these stakeholders was good and issues raised at these workshops were further considered by the Working Group. In addition to the Working Group, the Department of Public Enterprises separately examined options relating to the management of dividends arising from the Government's equity stake in the PNG LNG project.

A joint Cabinet Submission reflecting both the Working Group's work and the separate work undertaken by the Department of Public Enterprises recommended for the establishment of a consolidated pool of offshore funds with three coordinated and integrated funds - the stabilization fund, infrastructure fund and a future (savings) fund.

12.2 ECONOMIC CONSIDERATIONS

The emergence of a new resource sector through LNG production presents an opportunity to significantly advance and develop PNG. The adoption of appropriate mechanisms to manage these revenues will allow the Government to underpin its development objectives as set out in the PNG Development Strategic Plan, 2010-2030 (DSP) and Papua New Guinea Vision 2050 (PNG Vision 2050).

Notwithstanding this opportunity, it is most likely that the scale of LNG as a new and major revenue source will give rise to major macroeconomic pressures such as exchange rate appreciation (Dutch Disease), increased liquidity and higher overall demand within the economy. This would undermine the competitiveness of the non-mineral sectors of the economy, such as agriculture, potentially having a severe impact on activity, employment and incomes in labour sensitive sectors of the economy.

Past experience from the emergence of new resource sectors and earlier commodity booms indicates that PNG has not successfully translated these revenues into improved socio-economic indicators and sustained development outcomes to the extent that might be expected. Accordingly, the country cannot afford to squander this opportunity by dismissing the macroeconomic risks that need to be managed.

Given the opportunities and economic challenges that the emergence of the LNG sector presents, it is very important to have in place a robust fiscal framework to support the management of windfall revenues to underpin social and economic development in PNG.

12.2.1 Monetary Policy

From a monetary policy perspective, an increase in domestic liquidity would have immediate and adverse implications. One major issue relates to the need for Bank of Papua New Guinea (BPNG) to mop up the excess liquidity in order to avoid large inflationary pressures building up. This would substantially increase the cost of monetary policy operations that would ultimately be financed from the Government's Budget.

If inflation breaks out, it will seriously disadvantage all Papua New Guineans, particularly those that are not direct beneficiaries of the PNG LNG project and those on lower incomes – this would be associated with a lot of discontent and there would be some big winners as well as a lot of big losers from the PNG LNG project.

In addition, an appreciation of the Kina will reduce the value of foreign reserves and may cause an unrealised loss on BPNG's holdings of foreign assets. Both issues would have serious ramifications for BPNG's operation and management of its balance sheet, requiring budgetary support to prop up BPNG's capital.

12.2.2 Exchange Rate Issue/Dutch Disease

The large inflow of foreign currency from the LNG revenue is most likely give rise to major macroeconomic pressures such as exchange rate appreciation (Dutch Disease).

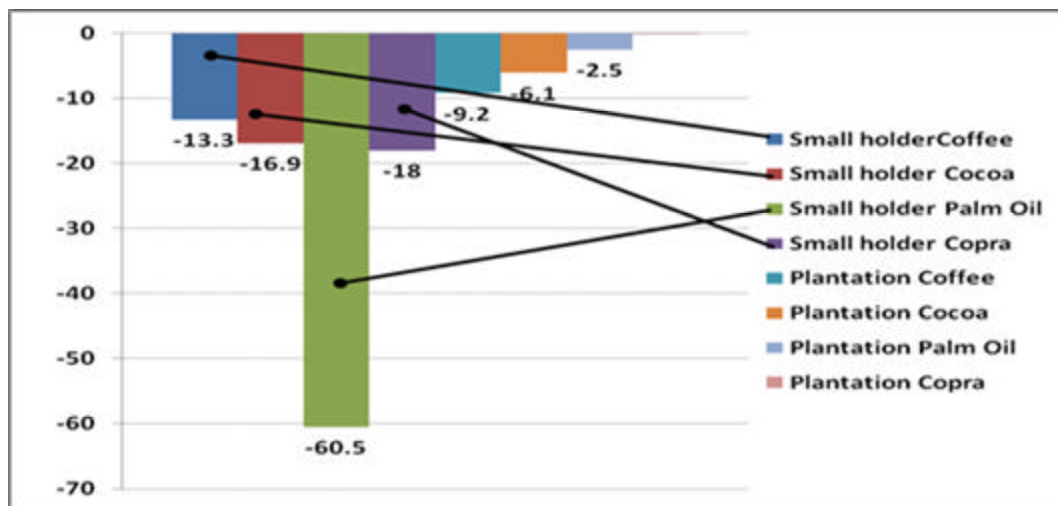
PNG LNG exports are expected to be large relative to current GDP, trade flows and foreign income and capital flows, which makes PNG highly susceptible to Dutch Disease.

A substantial increase in exports from the PNG LNG project will cause the real exchange rate to appreciate, all else being equal. This reduces the price of imported goods and increases the price of exports on international markets. This decreases the competitiveness of non-mineral sectors of the economy, such as agriculture, leading to lower economic activity and employment in these sectors across most provinces in PNG.

The ACIL Tasman analysis of the economic impacts of the PNG LNG project highlights that while the Project will have a massive impact on the PNG economy as a whole, it will not directly benefit all sectors of the economy.

ACIL Tasman estimated that the Kina would appreciate by around 11.0 per cent over the life of the project (which Treasury regards as a very conservative estimate), which has the potential to reduce the external competitiveness of the non-mineral sectors like agriculture and forestry.

Figure 44: ACIL Tasman modeled the impact of PNG LNG project in the Agricultural Sector (%)



Source: ACIL Tasman Report on "PNG LNG Economic Impact Study", 2008

Figure 44 shows the findings by the ACIL Tasman on the impact of PNG LNG project in the agricultural sector in the long run. Value added in the smallholder sector potentially declines at much higher rates than in plantations, ranging from 13.0 per cent (smallholder coffee) to 61.0 per cent (smallholder palm oil). Value added in the plantation crop sector could decline in the long run at rates ranging from 3.0 to 9.0 per cent.

This adverse modeled impact on the agriculture sector is a classic example of the potential impacts of Dutch Disease.

12.2.3 Fiscal Policy – Absorptive Capacity of the Economy

From a fiscal policy perspective, notwithstanding the country's substantial development and investment needs, the domestic economy has a limited capacity to absorb large amounts of additional Government spending in the short-term that would be financed from LNG revenues.

Government spending will be increased in order to achieve development objectives. However, in order to maintain macroeconomic control, any increased spending needs to be set in accordance with the absorptive capacity of the economy.

The absorptive capacity of the economy relates to the ability of the PNG economy to absorb increased Government spending. It can be broadly categorized under three distinct measurement constraints. These include:

1. *Macroeconomic constraints* – productive capacity;
2. *Quantitative constraints* – skilled workers to deliver services, physical capital and infrastructure; and

3. *Institutional constraints* – management of budget, regulatory and legislative institutions, the limited ability of the public service to translate funds into high quality development projects and service delivery to front line users.

If increased spending causes the economy to overheat, excess demand pressures will increase imports and inflation, causing investments in the economy to represent poor value for money and worsen rather than improve development prospects.

Assistance from the Australian Government and the IMF/World Bank to prepare economic modeling on the absorptive capacity of the economy was sought. Given time constraints and complexity of the modeling work, firm conclusions could not be drawn from this preliminary work and more modeling is expected to be undertaken.

The input provided by the Australian Government did not provide any substantive conclusions about the absorptive capacity of the economy. Moreover, the IMF/World Bank modeling suggested that additional Government spending arising from LNG revenues could grow sustainably in accordance with growth in non-mineral GDP. This equates to an increase in Government investment spending of up to about 6.0 per cent per annum over the medium term. The Working Group considers this recommendation by the IMF/World Bank to be conservative. Some other domestic stakeholders argue that development needs in PNG are such that all funds should be brought onshore and spent immediately. This is a radical and dangerous view that would be very likely to result in severe economic instability and losses for the majority of the population. The Working Group recommends a balanced approach that will allow for a substantial lift in development spending while maintaining macroeconomic stability.

Subject to further economic modeling being completed and considered by Government, preliminary analysis by the Working Group suggested a revised Medium Term Fiscal Strategy (MTFS) rule concerning Government spending from mineral revenue (including LNG revenue into the future) provides a possible start point for determining future Government spending.

This could mean that a large boost to the economy by LNG Project(s) would also allow for a large increase in Government spending in absolute terms. This would allow for a potential substantial boost to targeted development spending without putting macroeconomic stability at undue risk. This matter will be further considered in the context of a new MTFS by the Department of Treasury as the current MTFS will expire in 2012.

It is important to recognise that over recent years, the shortage of funds has not been an obstacle that has prevented effective development spending on infrastructure projects. Instead, it has been the poor ability of the public sector to establish and deliver credible project plans that has seen funds languish rather than being put to effective use. The availability of higher LNG funds will not see this problem disappear and it may intensify. This strongly argues against allocating excessive funds that cannot be effectively used. Moreover, recent experience indicates a poor track record of successfully translating development funds into effective infrastructure programs.

12.3 ESTABLISHING AN OFFSHORE SOVEREIGN WEALTH FUND (SWF)

One of the most fundamental economic issues the Government has considered is whether the fund should be an offshore or onshore entity. This is not a matter of sovereignty, as the

State will retain full ownership and control over its assets irrespective of whether they are held onshore or offshore. Rather, it is a choice about reducing macroeconomic risks and promoting macroeconomic stability, in addition to diversifying and maximising investment returns.

In considering this, the Government is conscious of the country's major development needs and the desirability of using LNG revenues in a manner that promotes macroeconomic stability while underpinning the DSP, PNG Vision 2050 and improving socio-economic outcomes. This is consistent with DSP's recognition of the importance of maintaining macroeconomic stability to underpin success of DSP.

It is critical in this respect that the cost and benefit of having an offshore fund as opposed to an onshore fund are fully debated in a rational and realistic manner.

12.4 MAJOR IMPEDIMENTS OF ONSHORE FUNDS

A major issue associated with onshore funds, as has been experienced in the past with the Mineral Resource Stabilization Fund and trust accounts, is that they are all held in domestic currency. This has major ramifications for the exchange rate and the cost and difficulty of managing monetary policy given the high liquidity levels. The size of LNG revenue will be much higher than those that had to be dealt with in the past, and so will have much greater macroeconomic impacts. In addition, the delinking of actual Government spending from budget processes has weakened fiscal policy control, which tends to cause a range of serious macroeconomic pressures.

The ability of any onshore fund as an effective policy tool to manage or mitigate these important macroeconomic pressures is very limited.

The likely emergence of these issues, particularly excessive demand pressures, sizable appreciation of the Kina, and increased liquidity, is expected to have major ramifications for the operation of monetary and fiscal policy, as highlighted earlier – these pressures will be extreme if onshore rather than offshore funds are used.

In this regard, establishing an offshore fund will allow the Government to maximise its development spending while at the same time maintaining macroeconomic stability, including avoiding overheating the economy. Crucial macroeconomic stability objectives cannot be achieved with an onshore fund – this would be likely to result in activity and employment in our non-mineral sectors declining, and ordinary Papua New Guineans suffering needlessly across most provinces, either through reduced incomes, higher inflation or both. A key theme behind both DSP and PNG Vision 2050 is the expansion of the non-mineral sectors of the economy, especially in agriculture, manufacturing and tourism. In order to be able to assist rather than set back our export and import competing industries, it will be critical to establish an offshore rather than onshore SWF.

12.5 DESIGN OF SOVEREIGN WEALTH FUND/S

The design and institutional framework of an appropriate SWF/s has been guided by international best practice, the Sovereign Wealth Fund Generally Accepted Principles and Practices (Santiago Principles), and domestic requirements.

12.5.1 Objectives of a SWF in PNG

PNG's circumstances suggest that the following are the most important considerations in establishing a SWF:

- Macroeconomic stabilization - volatile and unpredictable mineral and non-mineral resource revenue, contributing to short-term macroeconomic stability (including the cost and operation of monetary policy) and avoiding deterioration in the quality of public spending;
- Improve economic and social development – to improve socio-economic development indicators through appropriate investment of the LNG revenue;
- Fiscal transparency and oversight – to enhance accountability, transparency and governance and to promote greater awareness of public financial management;
- Mitigation of Dutch disease - to counteract upward pressure on and volatility of the level of the real exchange rate, which affect the competitiveness of the non resource tradable sectors;
- Asset management - to help manage (rising) financial assets accrued from natural resource revenue; and
- Savings - to build up wealth for future generations, ensuring intergenerational equality and long-term fiscal sustainability.

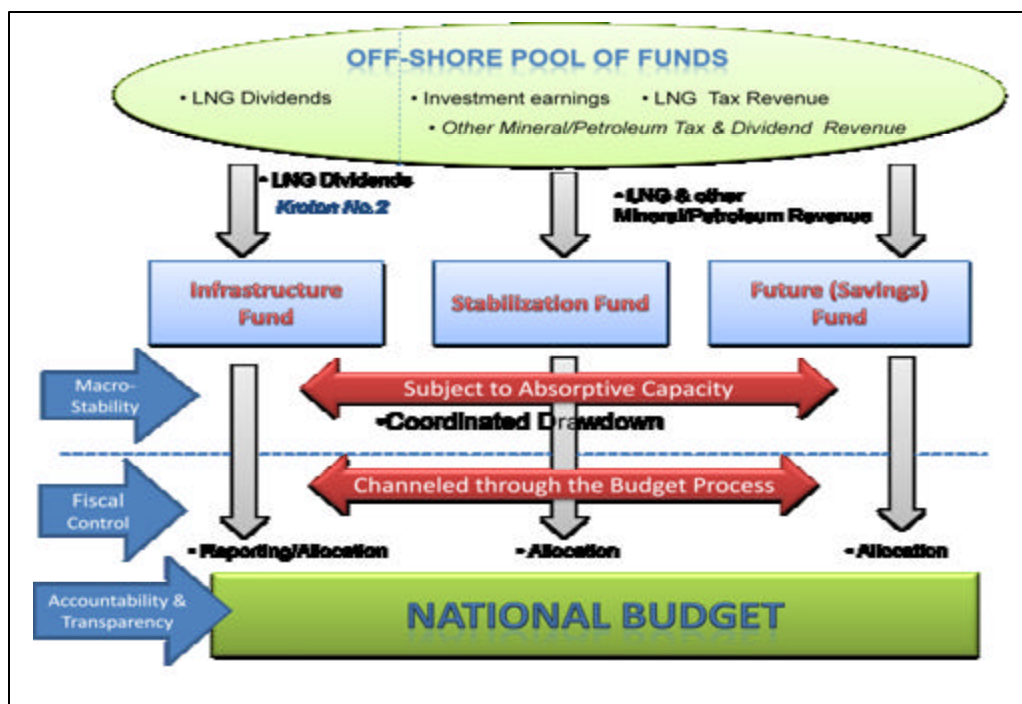
12.5.2 Recommended SWF Model for PNG

In light of the above circumstances, the Government has agreed to establish a consolidated pool of offshore funds with three coordinated and integrated Funds:

1. A Stabilization Fund (Stabilization SWF) established from LNG tax revenue and other mineral and petroleum revenue,
2. Future (Savings) Fund established from LNG tax revenue and other mineral and petroleum revenue, and
3. An Infrastructure Fund (Infrastructure SWF) established from LNG dividends.

These three funds will have three separate purposes:

- The purpose of the Stabilization Fund is to help reduce the impact of volatile and unpredictable mineral and resource revenues on the domestic economy to promote macroeconomic stability. The primary objective is to insulate the budget and the economy against movements in commodity prices and by ensuring that Government spending is in-line with the absorptive capacity of the economy.
- The purpose of the Infrastructure Fund is to provide capital towards the delivery of strategic national building infrastructure projects to promote the development goals of Papua New Guinea and ensure the aspirations of its people are met.
- The purpose of the Savings Fund is to promote savings to finance future spending and in order to smooth Government spending over the long term.

Figure 45: The relationship between the three funds

Under this model, drawdown arrangements from each fund needs to be coordinated and subject to the absorptive capacity of the economy in order to ensure prudent macroeconomic management while directly supporting the Government's development objectives.

12.5.3 Next Steps

Following Cabinet's agreement, a Secretaries Committee on Sovereign Wealth Funds will be established to oversee the establishment of the offshore Sovereign Wealth Fund for PNG with membership comprising the Secretary of PM and NEC, Secretary of Treasury, Governor Bank of PNG, Secretary of Public Enterprises, Secretary of National Planning and Monitoring, and Secretary of Justice and Attorney General. The Committee is to be chaired by the Secretary of Treasury.

In addition, an Inter-departmental Sovereign Wealth Fund Working Group will also be established to support the Secretaries Committee, with membership comprising the Department of Treasury, Bank of Papua New Guinea, Department of National Planning and Monitoring and Department of Public Enterprises, chaired by the Department of Treasury.

The design and establishment of Stabilization and Future (Savings) SWFs will be led by the Department of Treasury and Bank of Papua New Guinea in conjunction with key Government departments including the Department of Public Enterprises and the Department of National Planning and Monitoring. These four (4) departments will make up the Inter-departmental Sovereign Wealth Fund Working Group (ISWFWG) under the oversight and guidance of the Secretaries Committee on Sovereign Wealth Funds.

While the design and establishment of Infrastructure SWF will be led by the Department of Public Enterprises in conjunction with key Government departments including the Department of Treasury, the Department of National Planning and Monitoring and other key Government departments through the (ISWFWG) under the oversight and guidance of the Secretaries Committee on Sovereign Wealth Funds.

Within the SWF, the PNG LNG dividends will be accounted for separately and held for ultimate distribution through the budget for the purpose of strategic nation-building infrastructure, with details to be led by the Department of Public Enterprises in conjunction with Department of Treasury and other key departments and agencies.

Drawing on international best practice and past experience, key design elements of all SWFs will include:

- a) Establishing a consolidated pool of offshore funds.
- b) Fully integrating the SWF with the budget and fiscal framework.
- c) Governance, transparency, disclosure, accountability and asset management rules should be based on international best practice and Sovereign Wealth Fund Generally Accepted Principles and Practices.
- d) Drawdown rules need to be developed in order to ensure prudent macroeconomic management while directly supporting the Government's development objectives.
- e) The SWF should be overseen by an independent board which is established to act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions. The independent board should be supported by a secretariat from the Department of Treasury and the Bank of Papua New Guinea.
- f) Investments by offshore fund managers should be guided by a set of investment policies and guidelines that achieve a risk return trade-off acceptable to the independent board.
- g) Investment should be undertaken by an offshore investment manager/s who should invest only in foreign assets and be restricted from purchasing PNG government debt or investing or lending directly domestically.
- h) To minimise transaction costs and maximise efficiency, offshore investment of all LNG and mineral and petroleum tax revenue and related investment earnings should be channelled through a single pool of funds.
- i) Investment, management, and coordinated drawdown rules for the three funds.

The Secretaries Committee on Sovereign Wealth Funds will take all necessary steps to establish all three funds, including:

- a) Establishing funds in strict accordance with the design elements outlined above.
- b) Developing a detailed implementation schedule for the three funds.
- c) Identifying all legal, constitutional, budgetary, taxation, investment, planning and all other relevant considerations associated with the establishment of operation and drawdown of funds and seeking expert advice from government, development partners or other experts to identify and address any associated issues.

- d) Taking all necessary steps to establish an independent board and secretariat to support the establishment and operation of the funds, including criteria and arrangements for the establishment of a board.
- e) Undertaking a public information, education and awareness program across the country to foster understanding on this matter of national importance.

The Secretaries Committee on Sovereign Wealth Funds will provide regular updates to the Ministerial Committee for the Economic Sector and NEC.

Given the level of public interest in this issue, the Department of Treasury will provide annual updates on progress in establishing these Sovereign Wealth Funds in the annual Budget documents.

APPENDIX 1: REVENUE TABLES

Table 1.1: Summary of Infrastructure Tax Credit Scheme (Kina Million)

Table 1.2: Incentives Under the Income Tax Act Resulting in Permanent Loss of Revenue (Kina)

Table 1.3: Incentives Under the Income Tax Act Involving Deferral of Income Tax (Kina)

Table 1.4: Exemptions Under the Stamp Duties Act (Kina)

Table 1.1: Summary of Infrastructure Tax Credit Scheme (Kina Million)

	Actual 2005	Actual 2006	Actual 2007	Actual 2008	Est. 2009	Est. 2010	Proj. 2011
Total Mining & Petroleum Taxes Paid	1076.8	1946.5	2333.9	1961.8	693.1	1471.2	1594.7
Mining & Petroleum Taxes Paid by Companies involved in ITC	1076.8	1946.5	2333.9	1991.4	749.1	1325.3	1591
Total ITC Claimed & Allowed ¹	20.3	23.3	20.6	25.2	98.3	128.7	60
Expenditure Incurred on Approved ITC Projects ²	84.9	63.4	62.1	36.8	70.0	80.0	60
Amount Appropriated	20.3	23.3	20.5	25.2	40	60	60
Tax Credit Claimed as Percentage of Taxes Paid by Companies Subject to ITC	1.9	1.2	0.9	1.3	13.1	9.7	6.3
Excess Credits Carried Forward (from prior years) ³	na	na	na	na	na	na	na

Notes: 1. Approvals granted by Project Appraisal Committee on project expenditures claimed by the developers involved in the scheme. These figures are provided by the Internal Revenue Commission.

2. Actual expenditures incurred by the companies participating in the tax credit scheme. Some portion of the credits comprise the excess credits from past years.

3. The level of excess credits carried forward will be fully determined in 2011 once this scheme is reviewed.

Source: Department of Treasury, National Planning and Monitoring and Internal Revenue Commission

2011 Budget, Volume 1

Table 1.2: Incentives Under the Income Tax Act Resulting in Permanent Loss of Revenue (Kina)

Section	Description	2005		2006		2007		2008		2009	
		Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
25	Institutions and Hospitals	4	348,014	2	148,414		—	1	4,600		—
25A	Charitable Institutions	6	8,164,869	2	3,901,519		—	2	65,028		—
27	Non-Profit Bodies	1	23,911	3	896,816	2	3,101,292	1	378,576		—
35(1)	Exempt interest	17	1,403,878	7	502,516	2	27,534		—		—
35A	Fishing Operations		—		—		—		—		—
45B	Export Sales Exemptions	4	14,896,443	5	18,912,204			2	1,750,431	1	10,552
45I	Rural Development	4	3,592,213	4	2,144,577			1	618,105		—
45N	Bougainville Incentive		—		—		—		—		—
46AA	Rabaul Incentive		—		—		—		—		—
69A	Gifts to Sporting Bodies	1	158,397	2	3,700			2	2,980		—
69C	Gifts to Law, Order and Justice	1	261		—		—		—		—
69E	Gifts to Charities	4	9,646	1	450		—		—	1	15,965
69I	Gifts to National Day Celebrations		—	1	10,000		—		—		—
69J	Gifts to PNGSC 2000 Olympics		—		—		—		—		—
70A	Deduction for Education Expenses	22	404,107	13	149,090		—		—	1	6,600
72A	Double Deduction - Training	32	3,775,209	20	1,790,694	1	27,896	9	842,931	4	1,547,789
72C	Double Deduction - Export Market Development	4	119,357	6	144,895	1	674		—		—
95	Research and Development - 150%		—		—		—		—		—
97A	Primary Production Development Expenditure	2	2,848,016	1	4,149,637		—	1	124,207		—
97B	Agriculture Extension Services - 150%		—		—		—		—		—
CH 119	Pioneer Industries		—		—		—		—		—
		102	35,744,321	67	32,754,512	6	3,157,396	19	3,786,858	7	1,580,906

Note: Number means the number of tax payers claiming the concessions

A dash means one of the three: (1) no exemptions were granted, (2) no returns were lodged, (3) returns not yet assessed.

Source: Internal Revenue Commission

Table 1.3: Incentives Under the Income Tax Act Involving Deferral of Income Tax (Kina)

Section	Description	2005		2006		2007		2008	
		Number	Amount	Number	Amount	Number	Amount	Number	Amount
68A	Solar Heating		—	1	5,796		—		—
73(3)	Depreciation 20% loading	2	3,071,724	6	340,776	1	33,930		—
73(6)	Depreciation non-oil fired plant		—		—		—	1	12,365,347
73(7)	Depreciation - industrial plant	7	5,997,844	5	4,331,053	1	655,625	1	1,895,772
73(9)	Depreciation - Primary Production	3	2,128,907	1	218,446		—		—
		12	11,198,475	13	4,896,071		689,555.00		14,261,119

Note: Number means the number of tax payers claiming the concessions

A dash means one of the three: (1) no exemptions were granted, (2) no returns were lodged, (3) returns not yet assessed.

Source: Internal Revenue Commission

Table 1.4: Exemptions Under the Stamp Duties Act (kina)

Schedule 1	Description of Exemptions	2008		2009		2010	
		Number	Amount	Number	Amount	Number	Amount
Item 5	First Time Home Buyers Exemption	836	1,983,951	508	1,555,452	476	1,080,434
Item 5	Charities	8	176,250	4	58,210	4	45,030
Item 8	Wills	-	-	1	7,510	3	72,530
Item 16	Transfers of marketable securities	-	-	-	-	-	-
Section 6	Purchase of Property by State Instrumentalities	15	569,800	7	733,110	6	283,580
		859	2,730,001	520	2,354,282		1,481,574

Note: Number means number of transactions

2010 Figures are from January to September.

A dash means one of the three: (1) no exemptions were granted, (2) no returns were lodged, (3) returns not yet assessed.

Source: Internal Revenue Commission

APPENDIX 2: GRANTS AND TRANSFERS TO PROVINCES

Table 2.1: National Governments Grants to Provincial and Local Level Governments (Kina Thousand)

Table 2.2: Grants, Transfers and other resources of the Provinces (Kina Thousand)

Table 2.1: National Government Grants to Provincial and Local Level Governments (Kina Thousands)

	Personal Emoluments						Goods and Services											Total
	Salaries		Leave Fares		Village Court Allowance	Sub Total PE	Admin Grant	Other Services Grant	Health Function	Education Function	Transport Function	Village Court Function	Agriculture Function Grant	LLG Grants	Town & Urban Services	ABG Goods and Services	Sub Total G&S	
	PS Salaries	Teachers Salaries	PS Leave Fares	Teachers Leave Fares														
Western	12,409.0	22,153.3	247.6	1,001.2	274.0	36,085.1	141.0	141.0	879.1	893.5	1,658.9	127.6	618.1	2,092.5	0.0	0.0	6,551.7	42,636.8
Gulf	10,212.8	8,999.6	740.4	699.6	489.0	21,141.4	546.0	1,055.3	2,560.8	2,433.6	2,403.6	100.0	790.1	1,067.4	0.0	0.0	10,956.8	32,098.2
Central	12,682.6	29,957.1	322.9	2,106.2	297.7	45,366.5	404.8	1,270.4	2,407.2	3,005.3	3,562.8	153.9	325.1	1,513.8	0.0	0.0	12,643.3	58,009.8
NCD	0.0	0.0	0.0	0.0	195.1	195.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3,458.9	0.0	3,458.9	3,654.0
Milne Bay	11,106.1	28,508.9	461.7	1,163.7	316.9	41,557.3	1,073.0	1,539.2	4,138.2	2,948.1	3,124.8	76.2	889.4	1,945.2	0.0	0.0	15,734.1	57,291.4
Oro	9,876.3	13,534.1	450.2	962.2	138.2	24,961.0	595.4	827.4	2,142.8	1,795.4	2,065.7	42.5	927.8	1,492.3	0.0	0.0	9,889.3	34,850.3
S. Highlands	25,400.0	41,000.0	463.8	890.4	558.8	68,313.0	265.8	921.0	4,500.1	2,683.7	3,618.2	257.3	810.9	4,616.8	0.0	0.0	17,673.8	85,986.8
Enga	14,673.7	25,598.7	260.6	1,068.0	571.7	42,172.7	485.3	916.3	2,853.0	1,157.9	4,103.6	153.3	513.7	2,246.5	0.0	0.0	12,429.6	54,602.3
W. Highlands	13,507.3	39,316.3	483.4	1,311.3	653.3	55,271.6	455.8	757.5	3,362.4	4,357.3	4,278.4	274.3	1,366.6	3,609.2	0.0	0.0	18,461.5	73,733.1
Simbu	11,462.9	30,348.9	241.5	778.5	380.4	43,212.2	667.7	1,373.5	2,721.0	3,440.2	3,971.9	150.2	427.0	2,030.4	0.0	0.0	14,781.9	57,994.1
E. Highlands	15,430.5	37,000.0	752.0	1,156.5	437.4	54,776.4	1,090.0	1,391.8	3,236.0	3,707.9	5,177.8	153.0	1,203.1	3,494.6	0.0	0.0	19,454.2	74,230.6
Morobe	21,050.3	52,052.3	1,411.5	2,008.1	399.8	76,922.0	552.3	1,001.3	1,275.8	2,000.0	2,266.3	157.0	465.3	5,890.6	0.0	0.0	13,608.6	90,530.6
Madang	14,634.0	34,180.0	1,225.4	931.5	321.0	51,291.9	704.8	1,683.7	4,452.7	3,307.5	5,818.7	78.3	976.8	3,378.6	0.0	0.0	20,401.1	71,693.0
East Sepik	15,192.8	33,035.1	1,250.0	1,163.7	481.6	51,123.2	645.0	1,452.3	6,074.2	4,072.1	8,818.4	167.3	1,354.7	3,199.0	0.0	0.0	25,783.0	76,906.2
Sandaun	11,596.0	21,689.2	723.4	1,144.7	171.2	35,324.5	620.0	1,405.5	4,540.9	3,416.6	3,560.2	67.1	745.5	2,084.0	0.0	0.0	16,439.8	51,764.3
Manus	8,121.3	9,807.6	370.2	614.3	172.7	19,086.1	738.5	788.6	1,526.7	1,619.2	2,421.2	73.3	340.0	484.9	0.0	0.0	7,992.4	27,078.5
New Ireland	10,582.9	18,556.9	366.7	890.8	188.9	30,586.2	37.3	110.9	1,160.1	771.2	930.1	51.7	547.3	1,127.0	0.0	0.0	4,735.6	35,321.8
E. New Britain	14,800.0	34,193.8	340.1	1,274.1	264.0	50,872.0	81.1	454.7	2,082.2	2,591.2	2,242.1	70.6	1,527.3	2,289.5	0.0	0.0	11,338.7	62,210.7
W. New Britain	10,464.3	26,530.7	1,620.0	2,214.0	500.3	41,329.3	61.0	61.0	2,005.6	2,405.6	1,673.4	165.3	3,092.9	1,696.8	0.0	0.0	11,161.6	52,490.9
Bougainville	10,686.9	32,664.0	272.8	1,032.6	0.0	44,656.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	21,562.7	21,562.7	66,219.0
Total	253,889.7	539,126.5	12,004.2	22,411.4	6,812.0	834,243.8	9,164.8	17,151.4	51,918.8	46,606.3	61,696.1	2,318.9	16,921.6	44,259.1	3,458.9	21,562.7	275,058.6	1,109,302.4

Source: Department of Treasury and NEFC

Table 2.2: Grants, transfers and other resources of Provincial Governments (Kina thousands)

PROVINCE	Total Grants and Transfers		Sub Total National Government	Non-Grant tax transfers					Total
	Recurrent Budget	Development Budget		GST (1)	Bookmakers Tax (2)	Mining & Petroleum Royalties/Dividends (3)	Own Source Revenues (4)	Sub Total Non- Grant	
Western Province	42,636.8	27,300.0	69,936.8	2,648.0	0.0	56,800.0	9,297.5	68,745.5	208,619.1
Gulf	32,098.2	7,255.0	39,353.2	51.1	0.0	0.0	5.9	57.0	78,763.4
Central	58,009.8	5,850.0	63,859.8	962.8	0.0	311.8	10,509.6	11,784.2	139,503.8
NCD	3,654.0	5,978.0	9,632.0					0.0	19,264.0
Milne Bay	57,291.4	5,250.0	62,541.4	3,342.2	0.0	0.0	2,203.1	5,545.3	130,628.1
Oro	34,850.3	22,750.0	57,600.3	1,441.5	0.0	0.0	217.2	1,658.7	116,859.3
Southern Highlands	85,986.8	22,535.0	108,521.8	922.6	0.0	24,530.6	633.2	26,086.4	243,130.0
Enga	54,602.3	33,100.0	87,702.3	879.3	0.0	17,174.6	0.0	18,053.9	193,458.5
Western Highlands	73,733.1	33,000.0	106,733.1	11,991.1	433.8	0.0	2,671.8	15,096.7	228,562.9
Simbu	57,994.1	7,750.0	65,744.1	1,563.7	0.0	0.0	696.2	2,259.9	133,748.1
Eastern Highlands	74,230.6	19,250.0	93,480.6	10,822.3	274.0	0.0	1,511.7	12,608.0	199,569.2
Morobe	90,530.6	14,501.0	105,031.6	46,763.4	828.6	454.0	8,044.8	56,090.8	266,154.0
Madang	71,693.0	7,750.0	79,443.0	5,971.2	728.8	0.0	2,043.2	8,743.2	167,629.2
East Sepik	76,906.2	31,750.0	108,656.2	3,139.5	0.0	0.0	2,060.2	5,199.7	222,512.1
Sandaun	51,764.3	5,250.0	57,014.3	657.4	0.0	0.0	1,697.6	2,355.0	116,383.6
Manus	27,078.5	1,500.0	28,578.5	205.6	0.0	0.0	443.2	648.8	57,805.8
New Ireland	35,321.8	24,450.0	59,771.8	2,542.0	86.4	22,982.2	1,746.8	27,357.4	146,901.0
East New Britain	62,210.7	5,250.0	67,460.7	10,922.8	318.0	0.0	5,590.2	16,831.0	151,752.4
West New Britain	52,490.9	2,750.0	55,240.9	3,964.3	139.6	0.0	13,199.4	17,303.2	127,785.0
Bougainville	66,219.0	54,441.0	120,660.0	1,115.5				1,115.5	242,435.5
TOTALS	1,109,302.4	337,660.0	1,446,962.4	109,906.3	2,809.2	122,253.2	62,571.5	297,540.2	3,191,465.0

Source: Department of Treasury and National Economic & Fiscal Commission

(1) 60% of net inland GST collections, distributed to each province

Special distribution arrangements apply for Bougainville (Autonomy Arrangements), whereby it receives 30% of net inland GST collections in the province.

(2) 100% of 2009 net collection

(3) NEFC estimate, which includes dividends from equity shares of mining and petroleum resource projects paid to Provincial Governments.

(4) NEFC estimates (2009 actuals)

APPENDIX 3: ECONOMIC AND FISCAL DATA TABLES

Table 3.1	Gross Domestic Product by Economic Activity at Current and Constant Prices
Table 3.2	Contributions to Growth in Real Gross Domestic Product
Table 3.3	Prices of Main Export Commodities
Table 3.4	Volume of Main Export Commodities
Table 3.5	Value of Main Export Commodities
Table 3.6	Summary of Balance of Payments
Table 3.7	Employment Classified by Industry
Table 3.8	Central Government Revenue and Grants
Table 3.9	Central Government Expenditure and Net Lending
Table 3.10	Central Government Financing
Table 3.11	Monetary Aggregates
Table 3.12	Public Debt
Table 3.13	Major Assumptions Underlying the Budget

2011 Budget, Volume 1

TABLE 1: GROSS DOMESTIC PRODUCT BY ECONOMIC ACTIVITY AT CURRENT AND CONSTANT PRICES (Kina Million)

	2006 Actual	2007 Est	2008 Est	2009 Est	2010 Proj	2011 Proj	2012 Proj	2013 Proj	2014 Proj	2015 Proj
Agriculture, Forestry and Fishing										
nominal	5327.3	5901.7	6916.7	7207.9	8056.0	8664.0	9424.1	10120.6	10911.8	11787.4
deflator	160.5	170.7	191.7	198.4	214.3	222.2	232.8	242.8	252.4	263.2
real	3318.2	3458.3	3608.2	3632.4	3759.4	3899.3	4048.6	4169.1	4323.7	4478.9
rate of real growth	1.0	4.2	4.3	0.7	3.5	3.7	3.8	3.0	3.7	3.6
Oil and Gas Extraction										
nominal	2269.5	2422.7	2758.8	1676.9	1947.0	1517.5	1211.2	861.3	2735.1	12458.3
deflator	681.9	767.2	952.3	618.1	751.9	728.4	670.9	575.1	425.9	397.3
real	332.8	315.8	289.7	271.3	259.0	208.3	180.5	149.8	642.2	3136.1
rate of real growth	-3.4	-5.1	-8.3	-6.3	-4.6	-19.5	-13.3	-17.0	328.7	388.4
Mining and Quarrying										
nominal	2773.2	3022.0	3136.1	3038.0	3854.2	4201.3	4232.3	3517.0	2615.2	2229.0
deflator	397.5	423.4	432.5	418.3	493.2	465.0	392.5	338.5	358.0	297.8
real	697.6	713.8	725.2	726.2	781.4	903.4	1078.3	1038.9	730.5	748.4
rate of real growth	-10.7	2.3	1.6	0.1	7.6	15.6	19.4	-3.7	-29.7	2.5
Manufacturing										
nominal	974.7	1064.2	1247.6	1328.8	1500.1	1738.8	1936.9	2104.2	2319.9	2630.8
deflator	144.1	148.4	164.2	174.5	185.8	201.1	215.4	227.2	238.6	250.5
real	676.4	717.0	760.0	761.5	807.2	864.5	899.1	926.1	972.4	1050.2
rate of real growth	4.0	6.0	6.0	0.2	6.0	7.1	4.0	3.0	5.0	8.0
Electricity, gas and water										
nominal	337.7	361.8	404.1	461.7	534.5	636.4	742.9	787.5	893.1	1097.1
deflator	249.8	257.3	269.1	286.0	304.6	329.7	353.1	372.5	391.1	410.6
real	135.2	140.6	150.2	161.4	175.5	193.0	210.4	211.4	228.4	267.2
rate of real growth	1.3	4.0	6.8	7.5	8.7	10.0	9.0	0.5	8.0	17.0
Construction										
nominal	1437.2	1750.3	2226.2	2844.2	3453.2	4335.1	4829.1	5170.0	5482.7	6079.3
deflator	139.8	146.8	162.3	177.3	188.8	204.3	218.9	230.9	242.4	254.5
real	1027.9	1192.4	1371.2	1604.3	1828.9	2121.6	2206.4	2239.5	2261.9	2388.6
rate of real growth	12.0	16.0	15.0	17.0	14.0	16.0	4.0	1.5	1.0	5.6
Wholesale and retail trade										
nominal	1039.0	1177.3	1393.3	1569.9	1872.6	2330.6	2583.7	2752.4	2904.5	3293.7
deflator	166.5	171.5	189.7	201.6	214.7	232.4	248.9	262.5	275.7	289.5
real	624.1	686.5	734.6	778.6	872.1	1002.9	1038.0	1048.4	1053.6	1137.9
rate of real growth	8.4	10.0	7.0	6.0	12.0	15.0	3.5	1.0	0.5	8.0
Transport, storage and communication										
nominal	326.2	364.2	440.3	603.7	749.0	907.9	1060.0	1162.8	1282.0	1453.7
deflator	140.1	110.7	95.7	101.7	108.4	117.3	125.6	132.5	139.1	146.1
real	232.8	328.9	460.0	593.4	691.3	774.3	843.9	877.7	921.6	995.3
rate of real growth	5.0	41.3	39.8	29.0	16.5	12.0	9.0	4.0	5.0	8.0
Finance, real estate and business services										
nominal	579.4	638.6	760.0	929.0	1083.4	1313.2	1448.8	1535.8	1628.7	1889.7
deflator	158.4	166.3	186.7	198.5	211.4	228.8	245.0	258.4	271.4	284.9
real	365.7	384.0	407.0	468.1	512.5	574.1	591.3	594.2	600.2	663.2
rate of real growth	9.7	5.0	6.0	15.0	9.5	12.0	3.0	0.5	1.0	10.5
Community, social and personal services										
nominal	1526.8	1635.0	1818.8	2010.1	2211.4	2475.3	2757.4	2995.6	3239.8	3537.8
deflator	131.5	135.4	146.3	157.0	167.2	180.9	193.8	204.4	214.6	225.3
real	1160.7	1207.1	1243.3	1280.6	1322.9	1368.3	1423.0	1465.7	1509.7	1570.1
rate of real growth	3.0	4.0	3.0	3.0	3.3	3.4	4.0	3.0	3.0	4.0
TOTAL GDP*										
nominal	16896.6	18802.2	21601.3	22207.0	25837.2	28718.0	30866.3	31647.1	34652.5	47096.7
rate of nominal growth	11.9	11.3	14.9	2.8	16.3	11.1	7.5	2.5	9.5	35.9
deflator	191.5	198.9	214.3	208.9	227.0	233.6	238.8	241.1	253.9	279.7
real	8823.0	9453.9	10079.1	10631.5	11381.1	12295.0	12923.0	13124.3	13647.5	16839.3
rate of real growth	2.3	7.2	6.6	5.5	7.1	8.0	5.1	1.6	4.0	23.4
Total non-mining GDP										
nominal	11853.8	13357.5	15706.4	17492.2	20036.0	22999.2	25422.7	27268.7	29302.2	32409.3
rate of nominal growth	7.4	12.7	17.6	11.4	14.5	14.8	10.5	7.3	7.5	10.6
deflator	152.1	158.6	173.3	181.6	193.8	205.7	218.0	228.5	238.7	250.2
real	7792.5	8424.3	9064.2	9634.0	10340.4	11183.3	11664.2	11935.6	12274.8	12954.8
rate of real growth	3.9	8.1	7.6	6.3	7.3	8.2	4.3	2.3	2.8	5.5

*Sum of industries less imputed bank service charge, plus import duties, less subsidies.

Source: Actual data for 2002 to 2006: National Statistical Office. Estimates and projections: Dept. of Treasury

TABLE 2: CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT
(Percentage points)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Actual	Est	Est	Est	Proj	Proj	Proj	Proj	Proj	Proj
Agriculture, Forestry and Fishing	0.4	1.6	1.6	0.2	1.2	1.2	1.2	0.9	1.2	1.1
Oil and Gas Extraction	-0.1	-0.2	-0.3	-0.2	-0.1	-0.4	-0.2	-0.2	3.8	18.3
Mining and Quarrying	-1.0	0.2	0.1	0.0	0.5	1.1	1.4	-0.3	-2.3	0.1
Manufacturing	0.3	0.5	0.5	0.0	0.4	0.5	0.3	0.2	0.4	0.6
Electricity, gas and water	0.0	0.1	0.1	0.1	0.1	0.2	0.1	0.0	0.1	0.3
Construction	1.3	1.9	1.9	2.3	2.1	2.6	0.7	0.3	0.2	0.9
Wholesale and retail trade	0.6	0.7	0.5	0.4	0.9	1.1	0.3	0.1	0.0	0.6
Transport, storage and communication	0.1	1.1	1.4	1.3	0.9	0.7	0.6	0.3	0.3	0.5
Finance, real estate and business service	0.4	0.2	0.2	0.6	0.4	0.5	0.1	0.0	0.0	0.5
Community, social and personal services	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.4
TOTAL GDP	2.3	7.2	6.6	5.5	7.1	8.0	5.1	1.6	4.0	23.4
Total Non-mining GDP	3.9	8.1	7.6	6.3	7.3	8.2	4.3	2.3	2.8	5.5

*Sum of industries less imputed bank service charge, plus import duties, less subsidies.

Source: Actual data for 2002 to 2006: National Statistical Office. Estimates and projections: Dept. of Treasury

TABLE 3: PRICES OF MAIN EXPORT COMMODITIES
(Kina per tonne fob, unless otherwise specified)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Actual	Actual	Actual	Actual	Proj	Proj	Proj	Proj	Proj	Proj
AGRICULTURE										
Copra	653	875	1372	823	872	845	901	946	957	957
Cocoa	4645	5573	6480	6977	8230	6003	4618	4387	4271	4156
Coffee	6444	7493	7772	7407	8657	7016	6264	6014	5763	5613
Palm Oil	1181	1826	2306	1667	2022	1884	1835	1810	1785	1785
Rubber	5409	5552	6632	4718	5008	5317	5650	6314	6314	6381
Tea	3212	3134	3062	3259	3133	2436	2387	2287	2237	2237
Copra Oil	1455	2368	3272	1958	2074	2010	2144	2251	2278	2278
Logs (K/m³)	186	201	185	186	176	172	173	175	176	177
MINERALS										
Gold (US\$/oz)	604	697	872	973	1150	1150	985	825	660	500
Copper (US\$/ton)	6731	7132	6963	5100	7115	7115	6335	5560	4780	4000
Oil (Kutubu Crude: US\$/barrel)	64	71	97	62	76	76	70	60	55	50

Source: Actuals from BPNG. Projections from IMF and Dept. of Treasury.

TABLE 4: VOLUME OF MAIN EXPORT COMMODITIES
('000 tonnes, unless otherwise specified)

	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Proj	2011 Proj	2012 Proj	2013 Proj	2014 Proj	2015 Proj
AGRICULTURE										
Copra	12.7	12.6	32.6	15.2	16.9	23.0	19.3	17.2	17.7	19.3
Cocoa	44.0	47.8	53.3	51.3	44.0	53.5	55.5	57.2	59.4	62.4
Coffee	52.3	54.6	67.0	62.2	61.5	70.5	68.2	70.2	73.0	76.7
Palm Oil	362.3	368.3	446.0	428.4	490.0	515.4	556.1	600.2	631.4	641.7
Rubber	4.4	4.1	4.9	5.4	5.6	5.8	6.0	6.3	6.6	7.0
Tea	6.6	6.4	6.1	5.6	4.9	5.2	5.1	5.1	5.1	5.1
Copra Oil	41.5	51.3	62.0	44.8	51.6	60.9	58.4	61.9	66.3	71.6
Logs	2653.0	2816.0	2512.0	1809.0	2235.1	2414.5	2435.6	2345.7	2279.9	2279.9
MINERAL										
Gold (tonnes)	56.7	57.5	63.3	63.3	64.4	70.5	78.1	77.3	61.8	66.0
Copper (tonnes)	216.7	199.4	185.7	153.7	163.1	168.3	175.1	150.0	0.0	0.0
Oil (million barrels)	14.5	13.8	12.2	10.0	10.9	8.3	6.9	5.4	4.1	2.6

Source: Actuals from BPNG. Projections from Dept. of Treasury.

2011 Budget, Volume 1

TABLE 5: VALUE OF MAIN EXPORT COMMODITIES
(Kina Million)

	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Proj	2011 Proj	2012 Proj	2013 Proj	2014 Proj	2015 Proj
AGRICULTURE, FORESTRY, FISHERIES										
Copra	8.3	10.3	45.1	12.4	14.8	19.4	17.4	16.3	16.9	18.5
Copra Oil	60.4	121.9	202.7	87.9	107.0	122.3	125.3	139.4	151.0	163.0
Cocoa	204.4	276.5	345.6	336.1	362.3	321.2	256.3	250.8	253.9	259.4
Coffee	337.0	408.4	520.2	460.3	532.6	494.4	426.9	422.1	420.7	430.2
Palm Oil	430.1	672.2	1011.9	714.3	990.8	971.2	1020.4	1086.3	1127.3	1145.7
Rubber	23.8	22.9	32.6	26.0	27.9	30.8	34.0	39.5	41.5	44.4
Tea	21.2	20.0	18.9	18.4	15.3	12.6	12.1	11.6	11.4	11.4
Other Agriculture (a)	133.0	175.9	162.1	179.6	197.5	212.5	227.4	243.3	260.5	261.5
Forest Products	526.7	631.2	537.9	456.7	480.6	506.7	514.7	496.2	482.1	479.8
Marine Products	88.6	117.3	108.0	119.7	131.6	141.7	151.6	162.2	173.7	174.7
Total Agricultural, Forestry, Fishing Exports	1833.5	2456.6	2985.0	2411.5	2860.4	2832.8	2786.1	2867.8	2938.9	2988.7
MINERAL										
Gold	3090.9	3674.4	4669.3	5366.7	6143.1	6516.5	6181.3	5121.1	3279.9	2652.5
Copper	4329.5	4172.7	3616.7	2025.9	3063.6	3062.9	2837.3	2132.6	0.0	0.0
Oil	2988.5	2983.6	3506.1	1610.4	2383.7	1762.9	1348.3	894.3	622.9	367.9
Refined Petroleum Products	263.9	503.5	510.7	239.2	296.8	293.3	275.6	240.9	779.6	2464.5
Other	39.4	55.2	44.0	45.9	362.9	595.3	1122.1	1114.3	2724.7	11462.3
Total Mineral Exports	10712.2	11389.4	12346.8	9288.1	12250.0	12230.9	11764.6	9503.1	7407.0	16947.1
TOTAL EXPORT VALUE	13168.8	14374.4	15331.8	11699.5	15110.5	15063.7	14550.7	12370.9	10345.9	19935.8

Source: Actuals from BPNG. Projections from Dept. of Treasury.

(a) Includes Oil Palm by-products, canned tuna and vanilla.

2011 Budget, Volume 1

TABLE 6: SUMMARY OF THE BALANCE OF PAYMENTS
(Kina Million)

	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Proj	2011 Proj	2012 Proj	2013 Proj	2014 Proj	2015 Proj
CURRENT ACCOUNT BALANCE	1354.2	550.2	2144.0	-1611.0	-6863.4	-13192.0	-13274.8	-11704.0	-12243.9	-4807.2
Balance of Trade in Goods and Services	3212.8	1942.4	3448.0	-367.0	-2905.4	-6915.3	-7409.7	-7360.7	-8671.9	956.8
<i>Goods Balance</i>	6767.0	6282.3	7195.6	4192.0	3212.8	428.1	128.4	-494.2	-2360.2	7194.9
Credit (Exports)	12851.0	14079.0	15675.0	12101.0	15110.5	15063.7	14550.7	12370.9	10345.9	19935.8
Debit (Imports)	-6084.0	-7796.7	-8479.4	-7909.0	-11897.6	-14635.6	-14422.3	-12865.1	-12706.2	-12740.8
<i>Services Balance</i>	-3554.2	-4339.9	-3747.6	-4559.0	-6118.2	-7343.4	-7538.1	-6866.5	-6311.7	-6238.2
Services Credit	965.1	1069.4	980.0	511.0	604.2	682.2	733.0	734.0	729.2	772.6
Services Debit	-4519.3	-5409.3	-4727.6	-5070.0	-6722.4	-8025.6	-8271.1	-7600.5	-7040.9	-7010.8
Income Balance	-2462.1	-2133.9	-1740.0	-1721.0	-4298.1	-6525.6	-6035.2	-4515.4	-3683.8	-5796.8
Income Credit	214.9	309.4	230.0	128.0	76.2	86.7	70.4	68.4	66.5	69.0
Income Debit	-2677.0	-2443.3	-1970.0	-1849.0	-4374.3	-6612.3	-6105.6	-4583.8	-3750.3	-5865.8
Transfers Balance	603.5	741.7	436.0	477.0	340.1	249.0	170.1	172.1	111.9	32.9
Transfers Credit	999.5	1218.8	1060.0	1046.0	991.6	996.8	996.8	1058.8	1064.7	1086.7
Transfers Debit	-396.0	-477.1	-624.0	-569.0	-651.5	-747.9	-826.7	-886.7	-952.8	-1053.9
CAPITAL AND FINANCIAL ACCOUNT^(a)	618.0	1001.0	-2796.0	1611.0	6863.4	13192.0	13274.8	11704.0	12243.9	4807.2
NET ERRORS AND OMISSIONS	-1972.2	-1551.2	652.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current account balance as percentage of Gross Domestic Product (GDP)	8.0	2.9	9.9	-7.3	-26.6	-45.9	-43.0	-37.0	-35.3	-10.2

Source: Actuals from BPNG. Projections from Dept. of Treasury.

(a) Capital and Financial Account includes changes in reserves.

TABLE 7: EMPLOYMENT CLASSIFIED BY INDUSTRY
(March 2002 = 100)

	2006 Annual	2007 Annual	2008 Annual	2009 Annual	2010 June Qtr
Retail	97.7	115.1	123.6	125.7	128.1
Wholesale	145.6	158.0	160.8	167.2	171.2
Manufacturing	132.6	142.4	156.6	166.1	156.4
Building and Construction	118.9	135.4	163.2	173.7	188.1
Transportation	108.2	115.2	125.2	126.8	129.1
Agriculture, Forestry, Fisheries	123.3	139.1	147.3	153.4	162.9
Financial and Business	112.4	114.4	122.7	132.9	131.4
 TOTAL NON-MINERAL	 119.1	 131.1	 141.9	 148.6	 150.3
MINERAL	111.1	128.5	137.8	141.8	149.1

Source: BPNG.

2011 Budget, Volume 1

TABLE 8: CENTRAL GOVERNMENT REVENUE AND GRANTS
(Kina Million)

	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Est.	2011 Proj	2012 Proj	2013 Proj	2014 Proj	2015 Proj
TAX REVENUE	4944.8	5854.0	5756.1	4974.5	6481.0	7331.0	7800.5	7547.9	7372.2	8093.8
TAX ON INCOME AND PROFITS	3823.5	4491.3	4352.6	3519.7	4706.7	5292.5	5501.7	5150.5	4825.6	5307.4
Personal Income Tax	907.0	1006.9	1108.8	1241.8	1497.4	1727.1	1932.1	2121.0	2326.9	2551.3
Company tax	550.6	723.7	888.1	1121.4	1219.7	1401.9	1547.3	1659.7	1783.5	1973.6
DWT	200.9	199.3	189.9	244.4	275.6	298.0	303.1	259.2	115.0	57.0
Mining and Petroleum Taxes	1946.5	2333.9	1961.8	693.1	1471.2	1594.7	1422.5	793.3	260.2	356.4
Interest withholding tax	22.1	19.3	22.7	32.0	42.4	42.4	42.4	42.4	42.4	42.4
Other Direct	92.4	111.2	99.0	83.1	104.3	119.7	132.3	142.0	152.5	168.7
Gaming Tax	104.0	97.0	82.3	103.9	96.1	108.6	122.0	133.0	144.9	158.0
DOM. TAXES ON GOODS AND SERVICES	784.3	958.5	992.7	1063.2	1240.5	1429.4	1641.9	1705.8	1815.1	1989.8
Excise	324.1	342.0	365.5	354.7	421.4	483.9	534.7	573.6	616.4	681.7
GST	401.1	557.5	610.9	703.0	812.8	938.3	1099.1	1123.6	1189.5	1297.9
Mining Levy	56.1	56.6	11.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Indirect	3.0	2.4	4.9	5.5	6.3	7.2	8.0	8.6	9.2	10.2
TAXES ON INTERNATIONAL TRADE	337.0	404.2	410.8	391.6	533.8	609.1	656.9	691.6	731.5	796.7
Import Duty	90.4	135.9	158.0	143.7	189.7	218.0	240.7	258.2	277.4	305.9
Export Duty	162.6	155.2	126.8	108.7	153.9	172.2	174.9	174.6	176.0	183.2
Excise Duty on Imports	84.0	113.1	126.0	139.2	190.2	218.9	241.3	258.8	278.1	307.6
NON TAX REVENUE	428.8	411.0	282.6	765.8	409.6	411.1	392.7	142.1	153.8	275.9
PROPERTY INCOME	339.3	290.7	188.0	138.0	299.1	289.4	261.4	0.0	0.0	109.5
Dividends	68.1	65.0	25.5	0.0	38.5	0.0	0.0	0.0	0.0	0.0
Mining and Petroleum Dividends	271.2	225.7	162.5	138.0	260.6	289.4	261.4	0.0	0.0	109.5
Other*										
INTEREST AND FEES FROM LENDING	0.6	0.5	1.2	6.9	4.0	4.0	4.0	4.0	4.0	4.0
OTHER NON TAX REVENUE	88.9	119.8	93.4	99.9	106.5	117.7	127.4	138.1	149.8	162.4
INJECTIONS FROM TRUST ACCOUNTS				521.0						
ASSET SALES	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL REVENUE	5373.6	6265.0	6038.7	5740.3	6890.6	7742.1	8193.2	7690.0	7526.0	8369.7
% of GDP	31.8	33.3	28.0	25.8	26.7	27.0	26.5	24.3	21.7	17.8
INFRASTRUCTURE TAX CREDITS	23.3	20.6	32.6	33.5	60.0	60.0	60.0	60.0	60.0	60.0
GRANTS	914.6	721.0	1002.0	877.5	1293.9	1526.1	1452.8	1402.6	1387.2	1387.2
Budgetary Support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project Support Grants	914.6	721.0	1002.0	877.5	1293.9	1526.1	1452.8	1402.6	1387.2	1387.2
TOTAL REVENUE AND GRANTS	6311.5	7006.6	7073.3	6651.3	8244.5	9328.1	9706.0	9152.7	8973.1	9816.9
% of GDP	37.4	37.3	32.7	30.0	31.9	32.5	31.4	28.9	25.9	20.8
PRINCIPAL RECEIPTS FROM LENDING	4.2	4.1	4.9	4.5	4.0	4.0	4.0	4.0	4.0	4.0
GROSS BORROWING	1268.2	4798.4	2768.7	2315.3	2103.8	2185.7	1100.0	1192.5	1627.2	1422.9
ASSET SALES	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL RECEIPTS	7584.0	11809.1	9846.9	8971.1	10352.3	11517.8	10810.0	10349.1	10604.3	11243.8
% of GDP	44.9	62.8	45.6	40.4	40.1	40.1	35.0	32.7	30.6	23.9

Source: Department of Treasury.

2011 Budget, Volume 1

TABLE 9: CENTRAL GOVERNMENT EXPENDITURE
(Kina Million)

	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Est.	2011 Proj	2012 Proj	2013 Proj	2014 Proj	2015 Proj
RECURRENT BUDGET										
NATIONAL DEPARTMENTS	1665.9	2098.4	2276.1	2403.4	2436.8	3432.2	3344.1	3469.3	3613.5	3774.5
Personal Emoluments (a)	698.0	834.7	919.6	986.7	1149.7	1704.6	1511.0	1598.9	1674.5	1742.6
Goods and Services	967.9	1263.7	1356.5	1416.7	1287.1	1727.6	1833.1	1870.4	1938.9	2031.9
General Goods and Services	786.6	1050.8	1133.6	1213.4	1065.8	1458.8	1553.3	1580.5	1639.3	1722.0
Education Subsidies	42.4	148.9	142.9	142.7	143.0	172.0	184.2	194.3	204.1	214.3
Pre-March 2003 Arrears Payments	33.9	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Structural Adjustment Payments	30.3	6.8	8.8	9.0	28.3	36.9	35.6	35.6	35.6	35.6
Court Orders	74.7	56.0	71.2	51.6	50.0	60.0	60.0	60.0	60.0	60.0
PROVINCIAL DEPARTMENTS	765.1	745.0	802.7	985.6	1013.7	1043.1	1137.7	1212.4	1270.2	1325.1
Personal Emoluments	662.5	621.6	668.4	791.4	803.2	789.6	831.6	854.886	890.0	927.0
Staffing Grants	191.3	183.6	204.8	247.4	320.6	261.7	272.8	263.6	264.5	265.4
Teachers' Salaries	471.2	438.0	463.6	544.0	482.6	527.8	558.8	591.2	625.5	661.7
Goods and Other Services	65.1	65.4	71.5	194.2	116.1	141.8	164.5	165.9	177.4	189.6
Administration / Block Grants	21.3	16.1	21.2	38.2	8.6	9.2	9.8	10.4	10.9	11.4
Other Service Delivery Function Grant				14.8	15.3	17.2	28.4	19.4	20.3	21.4
Health Function Grant	11.5	13.4	14.5	28.4	39.2	51.9	57.0	61.7	66.4	71.5
Education Subsidies / Function Grant	20.6	21.6	21.7	31.6	38.9	46.6	51.2	55.4	59.6	64.2
Primary production Function Grant	11.7	14.3	14.0	14.1	14.1	16.9	18.1	19.1	20.1	21.1
Conditional Grants	37.5	58.0	62.9	81.9	94.4	111.7	141.6	191.6	202.9	208.4
Provincial Infr / Transp Maint Grant	14.4	15.4	16.7	34.1	45.9	61.7	67.7	73.3	78.9	85.0
Local & Village Services / Rural LLG	16.5	37.4	40.9	33.7	34.2	35.1	38.6	41.7	44.9	48.4
Town and Urban Services/Urban LLG Grant	6.6	3.0	3.0	11.9	12.1	12.6	13.7	14.8	15.8	16.9
Village Court Function Grant	0.0	2.2	2.2	2.2	2.2	2.3	2.5	2.8	3.0	3.2
Equalisation Grant	0.0	0.0	0.0	0.0	0.0	0.0	19.0	59.1	60.2	54.9
AUTONOMOUS BOUGAINVILLE GOVERNMENT	46.5	50.0	52.3	60.9	58.0	66.2	69.7	73.1	76.5	80.1
Police Grant	2.0	2.1	2.2	2.3	2.4	2.6	2.8	2.9	3.1	3.2
Recurrent Grant	44.5	47.9	50.1	58.3	55.3	63.3	66.6	69.8	73.1	76.5
Conditional Grant	0.0	0.0	0.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Establishment Grant	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TRANSFERS TO STAT. INS.	234.3	238.6	256.7	270.5	269.4	319.2	334.7	346.4	356.8	367.5
INTEREST PAYMENTS AND FEES	307.0	370.1	381.1	449.2	387.0	430.4	431.5	413.7	441.3	462.3
Domestic	187.1	252.2	292.1	390.0	334.0	369.5	368.5	346.0	370.9	389.3
External	119.9	117.9	89.0	59.2	53.0	60.9	63.0	67.7	70.4	73.0
NET LENDING TO CSAs	-4.2	-4.1	-2.2	-3.3	-4.0	-4.0	-4.0	-4.0	-4.0	-4.0
TOTAL RECURRENT	3014.7	3498.0	3766.7	4166.3	4160.9	5287.2	5313.8	5510.8	5754.2	6005.5
% of GDP	17.8	18.6	17.4	18.8	16.1	18.4	17.2	17.4	16.6	12.8
DEVELOPMENT BUDGET										
GoPNG FUNDED PROJECTS	639.5	606.6	628.1	1471.2	2136.4	2515.0	2626.6	2576.6	2526.6	2426.6
DOMESTIC FUNDS (b)	471.2	483.2	511.2	1348.6	1807.5	2066.6	2066.6	2066.6	2066.6	2066.6
INFRASTRUCTURE TAX CREDITS	23.3	20.6	32.6	33.5	60.0	60.0	60.0	60.0	60.0	60.0
CONCESSIONAL LOANS	145.0	101.8	84.3	89.1	268.9	388.4	500.0	450.0	400.0	300.0
COMMERCIAL LOANS	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
DONOR FUNDED PROJECTS										
PROJECT GRANTS	914.6	721.0	1002.0	877.5	1293.9	1526.1	1452.8	1402.6	1387.2	1387.2
TOTAL DEVELOPMENT (PIP)	1554.1	1327.6	1630.1	2348.7	3430.3	4041.0	4079.4	3979.2	3913.8	3813.8
% of GDP	9.2	7.1	7.5	10.6	13.3	14.1	13.2	12.6	11.3	8.1
REAPPROPRIATION INTO TRUST ACCOUNT				172.5						
ADDITIONAL INVESTMENT/PRIORITY EXPENDITURE(b)	1207.0	1726.8	2155.0		653.3					
% of GDP	7.1	9.2	10.0		2.5					
TOTAL EXPENDITURE AND NET LENDING	5775.8	6552.4	7551.8	6687.5	8244.5	9328.2	9393.2	9490.1	9667.9	9819.3
% of GDP	34.2	34.8	35.0	30.1	31.9	32.5	30.4	30.0	27.9	20.8
AMORTISATION	1804.0	5249.9	2290.2	2279.1	2103.8	2185.7	1412.8	855.1	932.4	1420.5
Domestic	1434.0	4748.9	1834.0	2107.9	1919.2	1980.3	1204.0	639.4	696.2	1213.2
External	370.0	501.0	456.2	171.2	184.6	205.4	208.9	215.7	236.1	207.3
LOAN REPAYMENTS	4.2	4.1	4.9	4.5	4.0	4.0	4.0	4.0	4.0	4.0
TOTAL PAYMENTS	7584.0	11809.1	9846.9	8971.1	10352.3	11517.9	10810.0	10349.2	10604.3	11243.8
% of GDP	44.9	62.8	45.6	40.4	40.1	40.1	35.0	32.7	30.6	23.9

Source: Department of Treasury.

(a) National Departments salary and wages includes provisions for superannuation contributions, retirement payments and future pay rises for both national and provincial government employees, including school teachers.

(b) Includes Additional Priority Expenditure from 2010 onwards

TABLE 10: CENTRAL GOVERNMENT FINANCING
(Kina Million)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Actual	Actual	Actual	Actual	Est.	Proj	Proj	Proj	Proj	Proj
TOTAL REVENUE AND GRANTS	6311.6	7006.6	7073.3	6651.3	8244.5	9328.1	9706.0	9152.7	8973.1	9816.9
TOTAL EXPENDITURE AND NET LENDING	5775.8	6552.4	7551.8	6687.5	8244.5	9328.2	9393.2	9490.1	9667.9	9819.3
DEFICIT (-) / SURPLUS (+)	535.8	454.2	-478.5	-36.2	0.0	0.0	312.8	-337.4	-694.8	-2.4
% of GDP	3.1	2.4	-2.2	-0.2	0.0	0.0	1.0	-1.1	-2.0	0.0
NET EXTERNAL FINANCING	-219.0	-397.3	-456.2	-82.1	84.3	183.0	291.1	234.3	163.9	92.7
CONCESSIONAL FINANCING	-145.0	-206.2	-407.5	-30.0	141.3	251.0	357.1	300.8	232.2	143.5
New Borrowing	145.0	102.7	0.0	89.1	268.9	388.4	500.0	450.0	400.0	300.0
Less Amortisation	-290.0	-308.9	-407.5	-119.1	-127.6	-137.3	-142.9	-149.2	-167.8	-156.5
COMMERCIAL FINANCING	-11.0	-14.7	-16.0	-18.3	-19.2	-19.5	-19.5	-19.5	-19.5	0.0
New Borrowing	6.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less Amortisation	-17.0	-15.6	-16.0	-18.3	-19.2	-19.5	-19.5	-19.5	-19.5	0.0
EXTERNAL EXTRAORDINARY FINANCING	-63.0	-176.4	-32.7	-33.8	-37.8	-48.5	-46.5	-47.0	-48.8	-50.8
New Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less Amortisation	-63.0	-176.4	-32.7	-33.8	-37.8	-48.5	-46.5	-47.0	-48.8	-50.8
NET DOMESTIC FINANCING	-316.8	-54.2	934.7	118.3	-84.3	-183.0	-603.9	103.1	531.0	-90.3
DOMESTIC MARKET BORROWING	-304.0	72.7	934.7	84.0	-84.3	-183.0	-603.9	103.1	531.0	-90.3
New Borrowing	1130.0	4694.7	2768.7	2191.9	1834.9	1797.3	600.0	742.5	1227.2	1122.9
Less Amortisation	-1434.0	-4622.0	-1834.0	-2107.9	-1919.2	-1980.3	-1204.0	-639.4	-696.2	-1213.2
MRSF NET DRAWDOWN										
TEMPORARY ADVANCE	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
End period balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
less: Beginning period balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ASSET SALES FINANCING	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER DOMESTIC FINANCING	-12.8	-126.9	0.0	34.3	0.0	0.0	0.0	0.0	0.0	0.0
Change in check float	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
End period stock	150.0	-300.6	300.6	300.6	300.6	300.6	300.6	300.6	300.6	300.6
less: Beginning period stock	-150.0	300.6	-300.6	-300.6	-300.6	-300.6	-300.6	-300.6	-300.6	-300.6
POSF financing (a)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BPNG financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing Discrepancy	-12.8	-126.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in cash balances				34.3						
NET FINANCING	-535.8	-451.5	478.5	70.5	0.0	0.0	-312.8	337.4	694.8	2.4
MEMO:										
FINANCING REQUIREMENT	-316.8	-56.9	934.7	118.3	-84.4	-182.9	-603.9	103.1	531.0	-90.3
% of GDP	-1.9	-0.3	4.3	0.5	-0.3	-0.6	-2.0	0.3	1.5	-0.2
GROSS BORROWING	1268.2	4798	2769	2315	2104	2186	1100	1192	1627	1423
Domestic	1117.2	4695	2769	2226	1835	1797	600	742	1227	1123
External	151.0	103.7	0.0	89.1	268.9	388.4	500.0	450.0	400.0	300.0
Concessional	145.0	102.7	0.0	89.1	268.9	388.4	500.0	450.0	400.0	300.0
Commercial	6.0	1.0	0.0	0	0	0	0	0	0	0
Extraordinary	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GROSS AMORTIZATION	1804.0	5249.9	2290.2	2279.1	2103.8	2185.7	1412.8	855.1	932.4	1420.5
Domestic	1434.0	4748.9	1834.0	2107.9	1919.2	1980.3	1204.0	639.4	696.2	1213.2
External	370.0	501.0	456.2	171.2	184.6	205.4	208.9	215.7	236.1	207.3
Concessional	290.0	308.9	407.5	119.1	127.6	137.3	142.9	149.2	167.8	156.5
Commercial	17.0	15.6	16.0	18.3	19.2	19.5	19.5	19.5	19.5	0.0
Extraordinary	63.0	176.4	32.7	33.8	37.8	48.5	46.5	47.0	48.8	50.8

Source: Department of Treasury.

Note: 2005 includes the issuance of K457 million in Inscribed stocks to replace Treasury bills.

(a) In 2004 the Government provided a Bond issue of K63 million to the POSF in consideration of the obligation owed by the Government for accumulated superannuation contribution to the POSF scheme.

TABLE 11: MONETARY AGGREGATES
(Kina Million, unless otherwise stated)

	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 June*
Domestic Credit	3036.4	4049.2	5616.2	6564.60	6887.1
% Change	35.5	33.4	38.7	16.9	20.8
Net Credit to Central Government	962.4	171.1	-81.6	596.1	678.4
% Change	-13.6	-82.2	-147.7	-830.5	-273.5
Credit to Private Sector	2948.9	3961.2	5523.3	6480.1	6463.2
% Change	38.3	34.3	39.4	17.3	17.9
Money Supply	7040.2	8994.9	10001.4	11915.2	12588.0
% Change	38.9	27.8	11.2	19.1	19.7
Money Velocity (M3*) (average)	2.4	2.1	2.2	1.9	2.1

Source: BPNG

*through -the -year change

TABLE 12: PUBLIC DEBT
(Kina Million, unless otherwise stated)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Actual	Actual	Actual	Actual	Est.	Proj	Proj	Proj	Proj	Proj
Domestic	3101.0	3173.3	4083.1	4155.9	4066.9	3884.0	3280.0	3383.1	3914.1	3823.8
Treasury Bills***	1194.0	980.2	1734.3	1766.4	1479.9	1097.3	493.4	596.2	1077.2	1047.0
Inscribed Stock	1883.0	2174.8	2339.5	2384.8	2587.0	2786.6	2786.6	2786.9	2836.9	2776.8
Other Domestic debt**	24.0	18.3	9.3	4.7	0.0	0.0	0.0	0.0	0.0	0.0
Domestic debt as % GDP	18.4	16.9	18.9	18.7	15.7	13.5	10.6	10.7	11.3	8.1
External	3631.1	3145.7	2854.9	2788.2	2847.3	3030.3	3321.5	3555.7	3719.6	3812.3
International Agencies	3507.2	3038.1	2746.1	2698.7	2769.2	2971.7	3282.4	3536.2	3719.6	3812.3
Commercial Loans	123.9	107.6	108.8	89.5	78.1	58.6	39.1	19.5	0.0	0.0
Other Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt as % GDP	21.5	16.7	13.2	12.6	11.0	10.6	10.8	11.2	10.7	8.1
Total Public Debt Outstanding	6732.1	6319.0	6938.0	6944.1	6914.3	6914.3	6601.5	6938.9	7633.7	7636.1
As % GDP	39.8	33.6	32.1	31.3	26.8	24.1	21.4	21.9	22.0	16.2

Source: BPNG and Department of Treasury.

**Includes Temporary Advance Facility

Note: Based on existing borrowings to cover financing gaps 2005 to 2010.

Note: Government borrowings for the Gas project not yet included in these numbers.

TABLE 13: OTHER MAJOR ASSUMPTIONS UNDERLYING THE BUDGET

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Actual	Actual	Actual	Actual	Est.	Proj	Proj	Proj	Proj	Proj
Inflation										
Average on Average (%)	2.4	0.9	10.8	7.0	6.0	8.2	7.1	5.5	5.0	5.0
Dec on Dec (%)	-0.9	3.2	11.2	5.7	7.8	8.1	6.1	5.4	4.9	5.1
Exchange rate										
Real Exchange Rate Index (2007 = 100)	98	100	119	122	127	135	141	145	148	152
Interest rate										
T/Bills (average for the year)	5.0	5.0	5.9	7.3	5.5	7.0	7.0	7.0	7.0	7.0
Inscribed Stock (3 year yield)	6.0	5.7	7.6	9.2	8.1	9.0	9.0	9.0	9.0	9.0
Mineral Prices										
Gold (US\$/oz)	604	697	872	973	1150	1150	985	825	660	500
Copper (US\$/ton)	6731	7132	6963	5100	7115	7115	6335	5560	4780	4000
Oil (Kutubu Crude: US\$/barrel)	64	71	97	62	76	76	70	60	55	50

Source: Department of Treasury.