2019 Budget Strategy Paper

Presented by

Hon. Charles Abel, CMG, MP.
Deputy Prime Minister & Treasurer

29 August 2018
## Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>APEC</td>
<td>Asia-Pacific Economic Cooperation</td>
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<tr>
<td>CRF</td>
<td>Consolidated Revenue Fund</td>
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<tr>
<td>DPM</td>
<td>Department of Personnel Management</td>
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<tr>
<td>DSP</td>
<td>PNG Development Strategic Plan (2010-2030)</td>
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<tr>
<td>EITI</td>
<td>Extractive Industries Transparency Initiative</td>
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<tr>
<td>FRA</td>
<td>Fiscal Responsibility Act (2006/2014)</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GFS</td>
<td>Government Financial Statistics</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>LNG</td>
<td>Liquefied Natural Gas</td>
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<td>MTDP2</td>
<td>Medium Term Development Plan (2016-2017)</td>
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<td>MTDP3</td>
<td>Medium Term Development Plan (2018-2022)</td>
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<td>MTFS</td>
<td>Medium Term Fiscal Strategy (2018-2022)</td>
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<td>MTDS</td>
<td>Medium Term Debt Strategy</td>
</tr>
<tr>
<td>MTRS</td>
<td>Medium Term Revenue Strategy (2018-2022)</td>
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<tr>
<td>PE</td>
<td>Personnel Emolument</td>
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<tr>
<td>PNG</td>
<td>Papua New Guinea</td>
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<tr>
<td>PFMA</td>
<td>Public Finance Management Act</td>
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<tr>
<td>PEFA</td>
<td>Public Expenditure and Financial Accountability</td>
</tr>
<tr>
<td>RHS</td>
<td>Right Hand Side (axis)</td>
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<tr>
<td>SME</td>
<td>Small and Medium Enterprises</td>
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<tr>
<td>SOE</td>
<td>State Owned Enterprises</td>
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<tr>
<td>StaRS</td>
<td>Strategy for Responsible Sustainable Development</td>
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<tr>
<td>SWF</td>
<td>Sovereign Wealth Fund</td>
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<tr>
<td>TFF</td>
<td>Tuition Fee Free</td>
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Government of Papua New Guinea

2019 Budget Strategy Paper

I. PURPOSE

The publication of the Budget Strategy Paper is in compliance with the Papua New Guinea Fiscal Responsibility Act 2006. It is a key component of the Government’s Budget Reform agenda which aims to improve the preparation of budgets, provide for efficient management of public finances and further promote transparency and accountability.

The Budget Strategy Paper provides the public with an overview of the fiscal landscape of the country and the Government’s fiscal policy responses to these prevailing conditions. It also provides the public with an opportunity to gauge the Government’s record on delivering on its promises.


Specifically the framework will focus on the guiding principles presented in the Government’s 25 Point (100 Day) Plan (25PP) which direct the State’s focus towards a small, efficient government, an empowered private sector, a simple and fair fiscal regime, sustainable population growth, self-reliant and sustainable industries, import replacement initiatives, job creation through small-medium enterprise development, the Sovereign Wealth Fund and good governance.

The 2019 National Budget Strategy will contain:

i. Economic fiscal trends and issues;
ii. The Government’s 100 Days Plan;
iii. The 2019 Budget Strategy and the indicative fiscal parameters and policies for the 2019 Budget;
iv. The Medium Term Framework and projections;
v. Key budget policies; and
vi. Risks to the economic and fiscal outlook.

Fiscal data included in the Budget Strategy Paper is only indicative and is based on the MTFS 2018-2022 projections and information available at the time of preparation particularly since the Midyear Economic & Fiscal Outlook (MYEFO). The macroeconomic and fiscal forecasts will be updated
in the 2019 Budget to reflect any changes in economic and financial conditions as will the key 2019 fiscal strategies outlined in this document.

II. BACKGROUND - ECONOMIC AND FISCAL TRENDS AND ISSUES

The 2018 MYEFO projects GDP growth to decline to 1.0 per cent in 2018, which is more positive than earlier more dire projections following the earthquake.

The resumption of production in major mines affected by the 7.5 magnitude earthquake is particularly promising, given higher average output levels than before the earthquake. Oil and gas prices have remained elevated which is also positive, although gold and base metal prices have come off mid-year levels.

While the global economic environment has improved, growth in the domestic market has remained slow in 2018 after the February earthquake and given the continuing adverse effects of the foreign exchange imbalance and fiscal tightness. For 2019 and over the medium term, in contrast to the MYEFO GDP projections, the sustained lift in gas production over the second half of 2018 and which is expected to continue over 2019, coupled with the early works and services from the expected commencement of the Wafi-Golpu project, Pasca Petroleum Project and Papua LNG and the broader impact on the domestic economy, have been factored into the projections.

Consequently, real GDP is now expected to pick up to 2.3 per cent in 2019, 3.0 per cent in 2020, 4.3 per cent in 2021, 4.5 per cent in 2022, 5.2 per cent in 2023 and 5.8 per cent in 2024. Increased gas production is expected in 2024 which will sustain these higher GDP growth rates over subsequent years.

A compound average annual real GDP growth rate of 4.2 per cent is expected between 2018 and 2024, significantly higher than in recent years. Importantly the non-mining real GDP growth rate is expected to increase at a faster pace of 4.9 per cent per year on average over the same period driven by the Agriculture, Fishery and Forestry sector and the transport, accommodation and construction sectors.

Despite the expected lift in revenue from the projected more favorable conditions, the need to extinguish fiscal arrears and a continuation of financing and debt constraints, together with the rise in some less productive expenditure categories, will mean that it will be critical to maintain prudent fiscal management. As such, the application of a number of containment strategies will be required that will provide scope for the Government to achieve its stated priority expenditures within its debt constraints.

Therefore, the ongoing implementation of key structural reforms initiated with the 25PP remain critical. These include a renewed focus on strengthening the payroll, improved debt management, extinguishment of the foreign exchange imbalance, import replacement, the remitting of funds
through the Public Monies Management Regularisation Act (PMMR), tax
regime reform, launching new projects in health, telecommunications and
energy, the upgrading of the Highlands Highway, and improved procurement
and accountability processes.

The preparations for APEC 2018 have provided some impetus for further
growth with a number of key infrastructure projects being initiated such as
the submarine fibre-optic cable, the Port Moresby Sewerage project, the
upgrading of the Port Moresby road network, the construction and
expansion of hotel accommodation and conference facilities, and the
expansion of the Port Moresby International Airport.

Moreover, these reforms and investments are complementary to the
implementation of the Medium Term Fiscal Strategy (MTFS), Medium Term
Revenue Strategy (MTRS), Medium Term Debt Strategy and Medium-Term
Development Plan III (MTDP III), all of which aim to strengthen the
management of our public finances and guide the execution of the
2018 Budget. The 2019 Budget should build on this and continue to
broaden the revenue base, improve efficiencies in the cost of service delivery
particularly in the salaries and wages bill, contain utility costs, enhance the
quality of expenditure particularly related to capital spending as well as
restructuring the domestic debt portfolio and maturity profile.

There are some successes in 2018 such as the stabilisation and
improvement of a number of revenue streams and the continued control of a
number of adverse expenditure trends which has signalled a turnaround. In
line with 25PP, tax reform measures have commenced, debt restructuring
and inroads into the foreign exchange imbalance have made solid progress,
an agreement with Oil Search to supply oil to Napa Napa has been secured
and the PMMR Act has been enacted and trust funds have been swept back
to the CRF.

Importantly the outstanding NSL exit payment liabilities are being
addressed and will have been extinguished by end September 2018.

Moreover the inaugural sovereign bond issuance program has been
approved with all documentation finalized and proceeds of between US$500
million to US$1,000 million are expected by the end of September 2018. The
bond will assist in funding the Government’s fiscal needs over the 2018-20
period and facilitate a restructuring of the domestic debt market to lower
interest costs and risks and assist in easing the foreign exchange imbalance.

However, it will still be important to create the required fiscal space to be
able to manage the required decline in the debt ratio to 30 per cent of GDP
by 2022, to fund the Government’s social and infrastructure priorities, and
to provide a buffer to underpin more effective natural disaster resilience
efforts.

Following the receipt of the expected substantial external funding, it will be
essential to improve domestic debt management, control the rising debt
service trend and streamline budget financing over 2019 and beyond.
Overview: 2018 Mid-Year Fiscal Position

The mid-year fiscal performance shows only a modest deterioration in fiscal conditions, which is significant given the impact of the February earthquake on expenditure and revenue trends. At end June 2018 the fiscal deficit was K324.9 million or 0.4 per cent of GDP with a revenue outturn of K5,553.3 million and an expenditure outturn of K5,878.2 million. This is within our 2018 mid-year Budget targets. There are some positive outcomes and some trends that are being addressed to ensure that the 2018 National Budget targets including our debt to GDP ratio hits the lower 30.0 per cent band by 2022 as prescribed in the Fiscal Responsibility Act.

Fiscal expenditures are significantly lower than budgeted at mid-year, being only 39.9 per cent of budgeted spending levels, with higher personnel emoluments and utility payment trends being offset by strict control of warrants over other discretionary spending heads.

Total net borrowing in the first half of 2018 amounted to K812.9 million, with external financing accounting for K631.0 million (largely the proceeds from the Credit Suisse final tranche) and domestic financing accounting for K181.9 million.

2018 Revenue

The extensive revenue measures approved in the 2018 Budget and targeted in 25PP have generally been implemented. The lift in gas production in late 2017 has supported higher resource tax collections in 2018.

GST collections continue to be above budget showing greater compliance efforts by IRC. Mining and Petroleum tax collections are now expected to increase from K113.6 million in 2017 because as at July 2018, we are already at K423 million in 2018 prior to the last installment in October. Stamp duty collections and royalty and management fees are also expected to be above budget. Receipt of project grant funding is running above budget by mid-year.

In contrast, personal and company taxes are down modestly, in part, due to the offsetting of GST refunds and in part due to less buoyant domestic business conditions than anticipated at the time of the 2018 Budget. Notwithstanding this, the company tax collections continue to hover around 5.0 per cent above 2017 collections.

Import excise collections on tobacco and alcohol have also been on the decline over the first half of 2018 attributed in part to the increase in excise

Table 1: MYEFO 2018

<table>
<thead>
<tr>
<th></th>
<th>2017 Actual</th>
<th>2018 Budget &amp; MTFS 2018-22</th>
<th>June Outturn</th>
<th>2018 MYEFO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenue and Grants</td>
<td>11,525.1</td>
<td>12,730.6</td>
<td>5,553.3</td>
<td>12,943.8</td>
</tr>
<tr>
<td>Total Expenditure and Net Lending</td>
<td>13,319.7</td>
<td>14,717.9</td>
<td>5,878.2</td>
<td>14,931.1</td>
</tr>
<tr>
<td>Net Lending (+)/Net Borrowing (-)</td>
<td>-1,794.7</td>
<td>-1,987.3</td>
<td>-324.9</td>
<td>-1,987.2</td>
</tr>
</tbody>
</table>

Source: Department of Treasury
rates in the 2018 Budget. Departure tax collections have also been lower in the first half, too.

The Government has announced in the 2018 MYEFO some measures to improve the compliance in these areas. Overall, total revenues by the end of 2018 are expected to be higher than the 2018 Budget estimates by K213.2 million.

2018 Expenditure

On expenditure, it is noteworthy that interest payments are consistent with Budget projections at the end of June 2018 and the trend in recent years of over expenditure on this category appears to have been halted. Payments to commercial and statutory authorities are lower. Concessional loan and grant project expenditures are running to schedule.

The Government’s own-financed capital spending is running lower than budgeted by mid-year, although is higher than the same time last year. Importantly, capital expenditure increased by a further K78.6 million by mid-year through a transfer from the operational component in accordance with Section 5 of the Appropriation Bill.

In contrast, trends in personnel emolument expenditures are running above budget reflecting the back-dated payment of the 3.0 per cent pay rise granted to public servants in 2017 and a further 3.0 per cent pay rise granted in 2018 – both of which were not appropriated in the 2018 Budget and which are estimated to amount to K232.7 million. The expected lift in revenue above budgeted levels has provided the scope for funding these pay increases in 2018.

In addition, a number of off-line payments, such as overtime, have increased over the first half, in part due to additional hours for our service workers in dealing with the earthquake and on APEC preparations, as well as additional health workers employed to assist in a number of aid projects. Utility charges are also running somewhat above budget, but this is mostly due to the payment of some outstanding amounts from 2017.

Additional Policy Directives

To ensure the budget deficit remains on track in 2019 and the Medium Term Fiscal Strategy (MTFS) is maintained, the Government has issued a number of directives to departments and agencies comprising:

a) Instructions to the Public Sector Organisational Reform Team (PSORT) and the Organisational Structural & Personal Emoluments Audit Committee (OSPEAC) and the Department of Finance to introduce some hard budget ceilings for employment levels and off-line payments to ameliorate these adverse underlying trends and to bring this expenditure category (excluding the unbudgeted pay increase) back on track. This is an outstanding matter under the Government’s 25PP that must be addressed;
b) Following a number of audits on utility and rental charges, the introduction of measures to control this expenditure and to bring it back on track by end 2019;

c) Establishment of a high-level Task Force (Treasury, IRC, Customs and Finance) focused on improving compliance and the pass through of departure tax and import excise collections;

d) Instructions to IRC to accelerate the establishment of the Large Taxpayer Office in IRC and to implement fully the 2018 Budget changes to the policy on export duty on old-growth logs;

e) Instructions to the Treasury and Finance Departments to conduct, as a priority, discussions with state entities to re-examine dividend inflows, particularly relating to LNG dividends to Government; and

f) Instructions to the Treasury Department to find additional savings in the goods and services expenditure areas across all non-essential priority areas and in non-essential capital works programs that are funded by the Government.

2018 Fiscal Outlook

Given the June outturn report, seasonal projection trends and with the stipulated Government actions, the Fiscal Outlook for 2018 has improved modestly.

Total Revenue and Grants is projected to be K213.2 million higher than the 2018 Budget estimates. Total Expenditure and Net Lending is projected also to be K213.2 million higher than the 2018 Budget estimates, thereby maintaining the budget deficit at K1,987.2 million. At this level, total public debt is projected to reach K25,545.5 million, or 31.3 per cent of GDP. This compares to the 32.2 per cent expected in the 2018 Budget, with the decline in the ratio mostly due to the upwardly revised GDP projections for 2017 and 2018. As such, debt levels are clearly within the 30-35 per cent band as per the Fiscal Responsibility Act (as amended) (FRA) and debt at these levels is consistent with the declining trends in the MTFS 2018-22.

While the Government maintains its commitment to delivering major expenditure commitments in the MTDP Enablers and key Government priorities (TFF, infrastructure spending and SIPS), the immediate challenge for the Government as highlighted in the MYEFO is to maintain fiscal discipline throughout the second half of 2018 and fully implement its remedial actions if it wishes to be in accordance with its MTFS. The performance of borrowing and all funding sources are also crucial to achieve the desired outturns.

III. 25 POINT (100 DAY) PLAN (25PP)

To address a number of urgent priorities and mitigate budget deviations, the Government introduced its 25 Point (100 Day) Plan 25PP in August 2017 which was based on the Alotau Accord 2.
The Government intends to ensure that PNG “lives within its means. As such the Government’s fiscal policy will be managed carefully to ensure delivery of basic services as well as creating an enabling environment for private sector growth.

In line with this Plan the Government issued a number of important directives to departments and agencies in September 2017 which formed key parameters for the 2018 National Budget and will continue to underpin formulation of the 2019 Budget.

This policy invention by the Government is to:

✔ maintain Fiscal Discipline and boost foreign exchange;
✔ grow our revenues;
✔ strengthen our economic base;
✔ improve our governance record; and
✔ act strategically.

Specifically a number of measures contained in the 25PP have been progressed.

On the revenue front, the 90/10 revenue mobilization exercise has been codified through the Public Money Management Regularization Act. This has impacted positively on Non-Tax Revenue collections which have picked up in June 2018. It will also mean that the control of the CSA revenue accounts will mean higher ongoing collections than in previous years.

Tax compliance efforts and other key tax measures as highlighted by the MTRS 2018-2022 have been progressed by IRC and PNG Customs and will continue to be implemented in the medium term.

On the expenditure front, key reforms have been further highlighted in the MTFS 2018-2022 and progressed in 2018 with the underlying goal of maintaining fiscal discipline and improving governance.

IV. 2019 BUDGET STRATEGY AND MEDIUM-TERM FRAMEWORK

A. Economic Outlook

The global economy grew at 3.8 percent in 2017 and is expected to continue to strengthen to 3.9 percent in 2018. The growth in 2018 was driven by advanced economies, mainly the US, Euro area and Japan and supported by improved prospects for commodity exporters in the emerging markets and developing economies.

Economic growth was revised up to 3.0 percent in 2017 driven by record gas production, although the non-mining sector grew only modestly by 0.2 per cent reflecting subdued growth in the agricultural, forestry and fishing sector and falls in construction, accommodation and ICT. As per the June 2018 projections, PNG’s economy is projected to grow by 1.0 per cent in real
terms in 2018. This is mainly due to the impact of the earthquake in the first half of the year which led to a decline in oil and gas production by 5.9 per cent.

On a positive note, improved oil and gas prices and favorable production of LNG and coffee and cocoa are expected to boost economic activity over the second half of the year.

For 2019 and over the medium term, in contrast to the MYEFO GDP projections, the sustained lift in gas production over the second half of 2018 and which is expected to continue over 2019, coupled with the early works and services from the expected commencement of the Wafi-Golpu project and Pasca and Papua LNG and the broader impact on the domestic economy, have been factored into the projections. Consequently, real GDP is now expected to pick up to 2.3 per cent in 2019, 3.0 per cent in 2020, 4.3 per cent in 2021, 4.5 per cent in 2022, 5.2 per cent in 2023 and 5.8 in 2024.

Increased gas production from the third train is expected in 2024 which will sustain these higher GDP growth rates over subsequent years. A compound average annual real GDP growth rate of 3.9 per cent is expected between 2018 and 2024, significantly higher than in recent years. Importantly the non-mining real GDP growth rate is expected to increase at a faster pace of 4.9 per cent per year on average over the same period. This will be driven by the Agriculture, Fishery and Forestry sector and the transport, accommodation and construction sectors.

Again this underlies the success of the Government’s 25PP.

The growth prospects of other mineral and petroleum investment projects such as the P’nyang project, the Stanley Gas Project, other Petrochemical projects and the Frieda Copper mine, although not factored in current projections, are expected to strengthen growth in the medium-term above this still conservative projection. In addition, effective spending on key MTDP enablers will support efforts to broaden the economy and strengthen inclusive growth.

APEC-related spending and depreciation of the Kina against major trading currencies, particularly the US dollar, are the factors initially thought to be driving inflation. However, the headline inflation rate is projected to be a percentage point below the 2018 Budget projection of 6.9 per cent at 5.9 percent. Over the medium term, inflation is expected to steady at an average rate under 6.0 per cent\(^1\).

Table 2 presents the economic parameters that underpin the 2019 and medium term fiscal projections.

\[^1\text{MTFS projections}\]
B. The 2019 Budget Strategy & Indicative Fiscal Parameters

Consistent with the government’s 25PP and the MTFS 2018-22 objective of securing a gradual fiscal consolidation, the 2019 Budget deficit will be targeted at 2.2 per cent of GDP and the non-resource primary balance targeted at negative 0.7 per cent of GDP. This corresponds to a debt to GDP ratio of 32.1 per cent of GDP assuming the MYEFO projected deficit for 2018 is achieved.
To ensure the credibility of the Government’s 25PP and fiscal strategy, it is important to ensure that fiscal fundamentals remain as programmed, through a continuation of improved revenue collections, enhanced controls on expenditure and with debt levels maintained on the current MTDS trajectory which will allow the required gradual increase in fiscal space.

Enhanced fiscal space is necessary, not only to support our growth strategy over the course of the MTFS through critical socio-economic investments, but also to mitigate external shocks in the short and medium term.

To meet those objectives, the ongoing Public Financial Management reforms will need to be accelerated in 2019 to reduce leakages, improve the quality of spending and promote value for money. These include, among others, the full implementation of the PFMA, procurement reforms, budget reforms through amalgamating the recurrent and development budget, rebalancing the expenditure path towards capital investment and public wage bill reforms.

The reforms will be facilitated and supported in 2019 by the complete roll out of the Integrated Financial Management System (IFMS) and an improvement in government reporting through the GFS 2014 initiatives. This will result in key government fiscal statistics and reports generated in real time and accurately, that will support monitoring and evaluation efforts as well as transparency and accountability mechanisms.

The 2019 Budget’s fiscal parameters are consistent with medium term objectives which focus on:

(i) Stabilising the revenue to GDP ratio above 14.5 per cent over the medium term and building up a strong revenue base able to finance the Government’s medium and longer-term expenditure plans;

(ii) a medium term expenditure strategy that gradually reduces the expenditure to GDP ratio consistent with long-term revenue trends and delinking expenditure from resource revenue volatility to a significant extent, so as to promote fiscal sustainability and stability; and

(iii) a debt management strategy that delivers more options for lower cost longer term financing within prudent risks levels providing flexibility in financing budgets both through the year and over the economic cycle.
2019 Revenue Measures – Medium Term Revenue Strategy:

The 2018 Budget marked the beginning of a multi-year strategy to address falling revenue trends and the 2019 revenue strategy will ride on the back of progress made in 2018. The overall MTRS is focused on improving tax revenues and tax administration, and harmonising and simplifying tax legislation and tax policies.

These are grouped into 3 key pillars of reforms: (i) administrative reform; (ii) policy reform; and (iii) legislative reform.

In terms of tax administration reforms, significant progress was made in establishing a large tax-payers’ office, revising tax collecting agencies’ business processes and strengthening the compliance audit capacity division. Whilst at advanced stages, these reforms will commence yielding results in 2019.

The set of reforms for 2019 includes, among others, the improvement and/or establishment of regional and provincial tax centres across the country to decentralise tax administration services. These are aimed at improving the efficiency and effectiveness of tax administration.

Under the policy reforms, a number of policies such as the initiation of the SME tax regime outlined in the MTRS, and changes to excise and export duties on alcohol, tobacco, gaming, and raw products (fish and sawn-logs) have been introduced in 2018, and further refinement will be required in 2019 to achieve the programmed outcomes. With regards to expanding the tax base, efforts will be directed to the MTRS in this respect, such as exploring taxes used in other jurisdictions such as capital gains tax, limiting excessive use of zero rating to broaden the GST tax base, and continuing to review the resource fiscal regimes to reducing the deductible nature of several key revenue heads and to shift focus away from profitability to production.

Table 3: Medium Term Fiscal Balance 2018-2022 (Kina million)

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
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<tbody>
<tr>
<td>Total Revenue and</td>
<td>12,731</td>
<td>13,058.3</td>
<td>13,936.5</td>
<td>14,981</td>
<td>16,253.9</td>
</tr>
<tr>
<td>Grants % of GDP</td>
<td>15.9%</td>
<td>15.1%</td>
<td>15.1%</td>
<td>15.1%</td>
<td>15.1%</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>14,718</td>
<td>14,955.8</td>
<td>15,612.2</td>
<td>16,389.8</td>
<td>17,515.1</td>
</tr>
<tr>
<td>and Grants % of GDP</td>
<td>18.4%</td>
<td>17.3%</td>
<td>17.0%</td>
<td>16.5%</td>
<td>16.2%</td>
</tr>
<tr>
<td>Net Lending (+)/</td>
<td>-1,987</td>
<td>-1,897.5</td>
<td>-1,676</td>
<td>-1,408.8</td>
<td>-1,261.2</td>
</tr>
<tr>
<td>Net borrowing (-)</td>
<td>-2.5%</td>
<td>-2.2%</td>
<td>-1.8%</td>
<td>-1.4%</td>
<td>-1.2%</td>
</tr>
<tr>
<td>% of GDP</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-resource</td>
<td>-592</td>
<td>-442</td>
<td>-193</td>
<td>-10</td>
<td>98</td>
</tr>
<tr>
<td>Primary Balance</td>
<td>-1.0%</td>
<td>-0.7%</td>
<td>-0.3%</td>
<td>0.0%</td>
<td>0.1%</td>
</tr>
<tr>
<td>% of GDP</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Government</td>
<td>25,808</td>
<td>27,443</td>
<td>29,118.8</td>
<td>30,527.3</td>
<td>31,788.7</td>
</tr>
<tr>
<td>Debt % of GDP</td>
<td>32.2%</td>
<td>31.8%</td>
<td>31.6%</td>
<td>30.8%</td>
<td>29.5%</td>
</tr>
</tbody>
</table>

Source: Department of Treasury
The State Negotiation Team established to formulate the agreement for the expansion of gas has made significant progress on improved fiscal teams.

Legal reform of the tax regime will continue in 2019 with the updating and consolidating of the existing Income Tax Act and, where necessary, simplifying legislation and separating tax measures from administrative measures and modernising customs legislation.

This set of reforms will support efforts to meet the MTFS targets of stabilising revenue as a share of GDP to more than 14.5 per cent throughout the medium term.

The Other Revenue (Non-Tax) category increased significantly in 2018 with significant revenues gained from the one-off sweep of excess cash held in trust and operating accounts of the state agencies and departments through the Public Money Management Regularisation 2017 Act approved in 2018. The expected improvement in economic activity in 2019, along with the continuing control of CSA revenue accounts will mean solid collections of non-tax revenue going forward which has not been the case since legislation was amended to allow for revenue sharing with respective CSAs.

However, the financial performance of the SOEs and Statutory Authorities will need to continue to be closely scrutinised in 2019 as highlighted in the Government’s 25PP, (point 19 states that all SOEs and Statutory Authorities will be asked to submit financial statements for independent audit). Overall, although, the same quantum of “other revenue” is not anticipated in 2019, the reforms are ongoing and collections are expected to trend significantly above pre-2018 levels.

The indicative Total Revenue and Grants for the 2019 Budget is K13,058.3 million which is K114.5 million higher than the 2018 MYEFO projections and K327.6 million than the 2018 Budget projection. This indicative projection is based on the 2018 Mid-Year Economic and Fiscal Outlook and the revised GDP projections in this BSP.

Table 4: Indicative Revenue Projections for 2019 Budget (Kina Million)

<table>
<thead>
<tr>
<th></th>
<th>2018 MYEFO</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenue and Grants</td>
<td>12,943.8</td>
<td>13,058.3</td>
<td>13,936.5</td>
<td>14,981</td>
<td>16,253.9</td>
</tr>
<tr>
<td>Taxes</td>
<td>9,821.9</td>
<td>10,613.2</td>
<td>11,484.9</td>
<td>12,499.8</td>
<td>13,749.4</td>
</tr>
<tr>
<td>Taxes on income, profit and capital gains</td>
<td>5,568</td>
<td>6,104</td>
<td>6,651</td>
<td>7,258</td>
<td>7,913</td>
</tr>
<tr>
<td>Taxes on goods and services</td>
<td>3,618</td>
<td>3,847</td>
<td>4,138</td>
<td>4,510</td>
<td>5,071</td>
</tr>
<tr>
<td>Taxes on international trade and transactions</td>
<td>626</td>
<td>662</td>
<td>696</td>
<td>732</td>
<td>766</td>
</tr>
<tr>
<td>Donor Grants</td>
<td>1,025</td>
<td>943</td>
<td>932</td>
<td>932</td>
<td>932</td>
</tr>
<tr>
<td>Other revenue</td>
<td>2,097.3</td>
<td>1,502</td>
<td>1,520</td>
<td>1,549</td>
<td>1,572</td>
</tr>
</tbody>
</table>

Source: Department of Treasury

Expenditure Measures - Total Expenditure and Grants:

The 2019 expenditure projection will be guided by the implementation of the 2018 Expenditure Strategy as outlined in the MTFS and the MTDP III.
A series of Public Finance Management (PFM) reforms and stringent measures were adopted in 2018 to undertake the required fiscal adjustment. This was to facilitate the gradual rebasing of the expenditure path to more closely align with the non-resource revenue trend, and de-linking, to some extent, the expenditure growth path from the volatility of mineral revenues and this approach will remain an integral part of the 2019 expenditure strategy.

The Government will continue to prioritise poverty alleviating measures such as Tuition Fee Free Education, Free Primary Health Care, the Services Improvement Programs at the Provincial and District levels and critical commitments such as to debt service payments. At the same time other expenditure will continue to be managed efficiently by aligning warrants to the availability of cash.

On this basis, if development expenditures are to be increased to support economic growth and employment, then the Government must gain greater control over the public sector payroll and utility costs which continue to expand at higher than programmed rates.

While significant efforts will continue to focus on improving the quality of expenditure, a sizeable amount of arrears have accumulated over the last few years particularly in utilities, office rentals and contractual obligations which will have to be strategically managed in 2019. A number of audits have been commissioned in 2018 in relation to the procurement and distribution of medical drugs, utilities and office rentals and corresponding schedules of payments have been developed to systematically address these arrears. This will continue in 2019 with a view to crystallising all legitimate government arrears with an optimal strategy established to address them.

The public wage bill remains a challenge given its short-term rigidity. However efforts to rationalise and dampen its rapid growth will be elevated in 2019. While the Organisational Staffing and Personnel Emoluments Audit Committee (OSPEAC) and higher level Public Sector Organisational Reform Taskforce (PSORT) was commissioned in 2018 to oversee this reform, progress has been relatively modest.

An independent payroll audit was sanctioned in the second quarter of 2018 and its findings will shape the work plan of the OPSEAC and PSORT in 2019. In the meantime, the amalgamation and abolishment of agencies and departments exercise that commenced in 2018 will continue in 2019. In respect of capital expenditure, the Government will remain consistent in its development approach.

The 2018 Budget focused on stimulating economic growth with the Government’s elevated priority to invest in agriculture, tourism, fisheries, forestry and economic sectors, high impact projects and sustained investments in the social sectors, particularly health, education and law and order services. This approach has been formalised in the new MTDP III to be
launched in September 2018 and will form the basis for the 2019 investment plan. Consequently, some expenditure categories may be altered.

The emphasis on broad-based economic growth saw a number of initiatives being introduced in 2018, such as the SME incubation centre, the agriculture commercialisation fund and continued investments in key national infrastructure programs, including the highlands highway, the missing link commodity roads programs, coastal jetties, hydro and gas generation power stations and the international submarine cables which commenced the laying of the cable.

These projects are critical as they impact directly on lowering the cost of doing business, improving market access for rural farmers and improving and lowering the cost of communication. They will continue to be a priority in 2019, as the Government progresses its multi-year investment plan.

To strengthen project delivery in 2019, project management and monitoring processes will be reviewed to strengthen institutions governing the overall project management and monitoring process. This will ensure that significant project proposals are thoroughly assessed through cost-benefit analyses, scoped within the multi-year financing schedule, including with adequate counter-part funding arrangements, and also ensuring that the existing projects are adequately funded.

Hence the indicative total expenditure and Net Lending for 2019 is K14.9 billion, K238.5 million higher than the 2018 MYEFO projection.

**Table 5: 2019 Budget - Indicative Expenditure & Net Lending Projections (Kina Million)**

<table>
<thead>
<tr>
<th></th>
<th>2018 (MYEFO)</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenditure &amp; Net Lending</td>
<td>14,717.8</td>
<td>14,955.8</td>
<td>15,612.2</td>
<td>16,389.8</td>
<td>17,515.1</td>
</tr>
<tr>
<td>% of GDP</td>
<td>18.4%</td>
<td>17.3%</td>
<td>17.0%</td>
<td>16.5%</td>
<td>16.2%</td>
</tr>
<tr>
<td>Expense</td>
<td>10,044.0</td>
<td>10,029.6</td>
<td>10,248.7</td>
<td>10,469.4</td>
<td>11,266.5</td>
</tr>
<tr>
<td>% of GDP</td>
<td>12.5%</td>
<td>11.7%</td>
<td>11.1%</td>
<td>10.9%</td>
<td>10.5%</td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>4,163.0</td>
<td>4,266.2</td>
<td>4,397.2</td>
<td>4,532.1</td>
<td>4,671.1</td>
</tr>
<tr>
<td>Use of goods and services</td>
<td>3,004.5</td>
<td>2,649.9</td>
<td>2,641.4</td>
<td>2,695.2</td>
<td>2,965</td>
</tr>
<tr>
<td>Interest</td>
<td>1,864.7</td>
<td>2,009.5</td>
<td>2,105.9</td>
<td>2,136.6</td>
<td>2,323.6</td>
</tr>
<tr>
<td>Grant</td>
<td>499.9</td>
<td>572.3</td>
<td>572.3</td>
<td>572.3</td>
<td>572.3</td>
</tr>
<tr>
<td>GST Transfers to Provinces</td>
<td>511.9</td>
<td>531.7</td>
<td>531.9</td>
<td>533.2</td>
<td>534.5</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>4,673.88</td>
<td>4,926.2</td>
<td>5,363.5</td>
<td>5,820.4</td>
<td>6,448.5</td>
</tr>
<tr>
<td>% of GDP</td>
<td>5.8%</td>
<td>5.7%</td>
<td>5.8%</td>
<td>5.9%</td>
<td>6.0%</td>
</tr>
<tr>
<td>GoPNG PIP</td>
<td>1,881.0</td>
<td>1,989</td>
<td>2,091</td>
<td>2,125</td>
<td>2,323</td>
</tr>
<tr>
<td>Service Improvement Programs</td>
<td>1,174.4</td>
<td>1,177.2</td>
<td>1,177.2</td>
<td>1,177.2</td>
<td>1,177.2</td>
</tr>
<tr>
<td>Loans Drawdowns</td>
<td>593.9</td>
<td>816.9</td>
<td>1,163.3</td>
<td>1,585.9</td>
<td>2,016.2</td>
</tr>
<tr>
<td>Project Support Grants</td>
<td>1,024.6</td>
<td>943.1</td>
<td>932.1</td>
<td>932.1</td>
<td>932.1</td>
</tr>
</tbody>
</table>

Source: Department of Treasury
Financing Measures

In 2019, the Government is projecting a budget deficit of less than K1.9 billion which is slightly lower than the expected 2018 MYEFO outcome of K2.0 billion.

The proposed reduced budget deficit in 2019, although modest, is expected to further ease pressure on the domestic debt market for funds. The gradual restructuring of the debt portfolio towards external debt initiated in latter part of the 2017 and over 2018 to date has, to some extent, eased this pressure. However these efforts will need to be maintained over the remainder of 2018 and in 2019. The restructuring of the debt portfolio does not only reposition the Government’s debt portfolio to be more robust structure to weather market shocks going forward, but also mitigates against potential roll-over risk and reduces part of the financing uncertainties over the medium term.

As part of the measures to mitigate these risks and in order to free up funds in the domestic debt market, the 2018 Budget required the Government to embark on sourcing external funding from development partners at concessional rates in the form of “budget support” in 2018.

- A total of USD 600.0 million over three years was programmed starting in 2018 - USD 300.0 million each from the Asian Development Bank (ADB)\(^2\) and the World Bank Group; and

- A total of USD 500.0 million was to be raised from the inaugural sovereign bond issuance to support the 2018-20 fiscal program of which USD 200 million was programmed for 2018. The sovereign bond now is expected to be raised in one issuance of USD 500 million in 2018 with the USD 300 million additional amount to budget requirements in 2018 to be used for domestic debt redemptions and/or maintained in a USD account in the BPNG to fund the forward fiscal program.

Overall, these loans will support expenditure in key sectors, while freeing up space for the Government to continue its debt portfolio restructuring program in 2019.

The Government also plans to collaborate with the Bank of Papua New Guinea, key investors and other key stakeholders to develop, deepen and strengthen the market for the government securities. Arrangements are in process to convert the NSL exit payment debt into domestic securities, allowing the extinguishment of this debt by the end of 2018.

\(^2\) ADB loan was secured in the third quarter for 2018 with USD100.0 million supporting the 2018 Budget.
### Table 6: 2019 Budget - Indicative Deficit Financing Projections (Kina Million)

<table>
<thead>
<tr>
<th>Debt Instruments</th>
<th>2018 (MYEFO)</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Net Financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities</td>
<td>373.8</td>
<td>200.6</td>
<td>454.7</td>
<td>816.2</td>
<td>862.1</td>
</tr>
<tr>
<td>Treasury Bills</td>
<td>30.2</td>
<td>-108</td>
<td>156</td>
<td>87.7</td>
<td>-61.3</td>
</tr>
<tr>
<td>Inscribed Stock</td>
<td>343.6</td>
<td>308.6</td>
<td>298.7</td>
<td>728.5</td>
<td>923.4</td>
</tr>
<tr>
<td>External Net Financing</td>
<td>1,613.40</td>
<td>1,696.90</td>
<td>1,221.10</td>
<td>592.3</td>
<td>399.3</td>
</tr>
<tr>
<td>Sovereign Bond</td>
<td>640</td>
<td>640</td>
<td>320</td>
<td>0</td>
<td>-640</td>
</tr>
<tr>
<td>Loans</td>
<td>973.4</td>
<td>1,056.90</td>
<td>901.1</td>
<td>592.3</td>
<td>1,039.30</td>
</tr>
<tr>
<td>Concessional Loans</td>
<td>337.4</td>
<td>480.6</td>
<td>808.3</td>
<td>1,123.40</td>
<td>1,389.70</td>
</tr>
<tr>
<td>Commercial Loans</td>
<td>39.8</td>
<td>-17.9</td>
<td>-513.9</td>
<td>-513.9</td>
<td>-337.9</td>
</tr>
<tr>
<td>Extraordinary</td>
<td>596.2</td>
<td>594.2</td>
<td>606.7</td>
<td>-17.1</td>
<td>-12.4</td>
</tr>
<tr>
<td>Total Net Financing</td>
<td>1,987.20</td>
<td>1,897.50</td>
<td>1,675.80</td>
<td>1,408.50</td>
<td>1,261.4</td>
</tr>
</tbody>
</table>

Source: Department of Treasury

### V. 2019 POTENTIAL ENABLING STRUCTURAL POLICY REFORMS

The projected improved global economic outlook for 2019 presents the 2019 Budget a window of opportunity to further fast track the ongoing structural reform agenda and boost growth in 2019 and beyond. These reforms are necessary to improve the business environment and attract much needed foreign direct investment built on the successful hosting of APEC in 2018.

These reforms include advancing regulatory reforms, adopting sound policy frameworks to enhance competition and consumer protection, and implementing an effective public private partnership policy to facilitate infrastructure development.

Under the APEC Finance Ministers’ Process and Economic Committee, PNG has gained important insights into advancing reforms in relation to good regulatory practices and the ease of doing business, infrastructure development and financing, financial inclusion, international tax cooperation and transparency (in particular addressing Base Erosion and Profit Shifting (BEPS) practices) and enhancing capacity in disaster risk financing and insurance. Other reforms such as the financial inclusion programme implemented through BPNG and CEFI and addressing BEPS and Automatic Exchange of Information priorities through the IRC, have made significant progress in 2018 and will be consolidated in 2019.

Further areas of reforms based around creating an environment to facilitate the digital economy have also been identified for 2019.

As highlighted in 2018 and the associated medium-term plans, the Government is adopting a multi-year approach to engineer substantial reforms to the economy and its fiscal and financial management. Therefore,
2019 will be a continuation of 2018 with the aim of consolidating and reaping the benefits of the initiatives and reforms initiated in 2018 and in previous years.

Among these initiatives taken by the Government to promote expenditure efficiency and achieve key government priorities, the following will continue in 2019 and over the medium-term:

(a) Medium Term Revenue Strategy

Revenue generation, as mentioned above, will be an important key to the success of the O’Neill-Abel Government’s fiscal plans. This demands serious reforms to ensure an effective tax system coupled with increased investment in revenue raising initiatives.

Revenue reforms in the 2019 Budget will be aimed at growing the revenue base, broadening the tax base and improving tax payer and administration efficiencies through appropriate and effective investment in revenue raising agencies.

(b) Strengthening of the OSPEAC

This is a critical measure contained in the 25PP and the 2019 Budget will build on the progress made to date. In assessing the Government expenditure, the Public Service wage bill is the largest component of the expenditure items, and a slower year-on-year growth is needed to reduce the pressure on the National Budget and our capital investment.

(c) Strict Implementation of PFMA

The PFMA sets out requirements to ensure that all expenditure is properly authorised and applied to the purposes for which it is appropriated. The detailed controls over payments are set out in the Financial Management Manual and codify roles and responsibilities as well as all aspects of public money management across the different aspects of the budget cycle from budgeting to reporting, including procurement.

Building on progress made in 2018, the momentum in this reform will continue in 2019 and over the medium-term. The Government will ensure its strict implementation and ensure that sanctions approved are duly followed.

(d) Budget Reforms

To improve the integrity and efficiency of the budgeting process, the Government introduced a couple of reforms in 2018 which focused on promoting greater efficiency in public spending. These reforms included Integrated Budget, Multi-year budgeting process, Sector led-budgeting; and Performance based budgeting.

These reforms are consistent with the current MTFS’s expenditure strategy and will be continued in 2019.
(e) Complementary Structural Policies and reforms

Various policies progressed include the Community Service Obligation (CSO) policy, State On-Lending Policy and State Guarantee Policy which are aimed at addressing capacity challenges faced by state agencies to enable them to improve their productivity and efficiency in service delivery.

The government has also undertaken legal and regulatory reforms to address institutional inefficiencies and improve performance of institutions (state agencies) at all levels and in all sectors. The consolidation of the major State Owned Enterprises (SOE's) under the Kumul Reform Agenda is to effect better governance of state investments and improve their performance, whilst also maintaining efficient infrastructure service delivery. These reforms will continue to be progressed in the medium term.

The government introduced the PPP Policy and legislation in 2014 which will ultimately capitalize on private sector expertise in the delivery of public infrastructure service. The government is looking at the PPP modality to efficiently deliver major infrastructure projects.

To boost economic growth and diversify its revenue streams, the Government has introduced the Rebate Scheme policy (RS) in 2018 in the fisheries sector. This policy initiative aims to increase onshore processing, lift employment opportunities, and grow the revenue base and export earnings. The impact of this policy will be reviewed in 2019.

Commercialization of Agriculture is a significant step by the Government to strengthen agricultural reforms in rural and peri-urban centers. The spin-off benefits will stimulate domestic food production activities and limit imports of food products. Under the framework of the MTRS, the Government’s reforms to grow the revenue base for the economy can be achieved. This will continue to be pursued in 2019 and over the medium term.

The Extractive Industries Sector contributes a significant portion of overall GDP. The Wafi-Golpu, Frieda Mining Project, the Papua and P'nyang LNG Projects are expected to be permitted in 2019 and 2020, respectively. While development of these projects progresses, Government will emphasize the maximisation of its revenue gains. This entails ensuring the establishment of necessary policy and legislative changes to better regulate the sector. Proposed areas of reform include:

- Amending the Mining Act 1992 to better regulate the mining sector;
- Introducing a policy guiding state participation in resource projects and third party access in the oil and gas sector;
- Introducing a policy to guide the distribution and management of benefits to landowners and subnational governments;
• Introducing policies on domestic market obligation for gas and petroleum products; and
• Introducing policies and frameworks around ensuring national content issues are addressed.

Whilst the Government embarks on the policy and legislative changes, it also recognises the need to strengthen its concessional fiscal regime. The current concessional fiscal regime is considered generous compared to global standards. Hence, the Government will focus on a major reform towards getting a fiscal regime that is globally competitive and returns maximum gains to Government from resource extraction in 2019 and beyond.

VII. RISKS TO THE ECONOMIC AND FISCAL OUTLOOK

The risks to the PNG Economic and Fiscal Outlook include:

Macroeconomic risks:

• Uncertainty in global trade between the US and China continues to pose volatility risk that could impact adversely on commodity prices and our exports in the agriculture, fishery and the forestry and mining & quarrying sectors. Precious and base metal prices have declined significantly since the mid-year outlook was compiled;

• Continued imbalance in the foreign currency market poses a considerable risk to domestic economic activity and the inflation outlook;

• Natural phenomena such as landslips and weather-related issues, industrial accidents, landowner issues and other events can substantially affect output and government revenue, notably through their impact on resource projects; and

• Slower than expected implementation of large extractive investment projects will also impact on overall economic growth and anticipated revenue growth;

Fiscal risks:

• Unexpected delay in securing the World Bank budget support loan and execution of the inaugural sovereign bond issuance;

• Dividend collection and tax compliance revenue projections failing to meet end 2018 projections; and

• Fiscal risks have emerged from complacent fiscal management, including failure to control PE, which will add further pressure on the fiscal position and undermine the 2019 Budget fiscal parameters.

Debt Related Risks

• Exposure through debt guarantees and contingent liabilities is a concern in determining the net worth of the State, thus, has implications on the credit rating;
• Heavy reliance on domestic borrowing gives rise to high interest costs, the ability to refinance and the crowding out of private credit, while greater exposure to external borrowing increases exchange rate risks; and

• Careful fiscal management will be required to ensure debt levels remain sustainable. In this respect, NSO proposed revisions to the GDP data for 2015 and 2016 will impact nominal GDP data, lowering the base for ratios that use nominal GDP, which is particularly important for prescribed debt/GDP ratios which are likely to exceed the 35 per cent upper limit.

Mitigation strategies for these different risks will need to underline the 2019 Budget projections.

VIII. CONCLUSION

Although the 2019 Budget Strategy Paper continues the efforts in 2018 in building a solid foundation to strengthen revenue policies and collections, constrains expenditures and restructures debt. It maintains funding for the Government’s key priorities as well as increases funding for high-value capital projects. Progress will continue on budget reforms, implementation of PFMA reforms and other complementary policies.

The above set of policies have the specific endorsement and approval of NEC and will guide and direct central agencies and departments in the preparation of the 2019 Budget.