



MEDIUM TERM FISCAL STRATEGY 2002 - 2007

DEPARTMENT OF TREASURY

July 2005

The Government's Medium Term Fiscal Strategy 2002- 2007 (MTFS) outlined a plan of substantial fiscal adjustment supported by structural reforms.

Background

In mid-2002, the PNG economy was at the crossroads. Fiscal discipline had faltered, with the effect of significant overspending compounded by lower than expected revenue.

As a consequence, 2002 was the third successive year of declining GDP. Inflation was over 10 per cent and rising, the exchange rate was falling, interest rates rose to nearly 20 per cent, government debt rose to K9 billion (nearly 70 per cent of GDP) and a budget deficit of between 5 and 6 per cent of GDP was in prospect for 2002.

As bad as the situation was, the picture ahead was gloomier still.

Expenditure was projected to continue to rise, reflecting:

- high and growing spending on public servant salary and wages;
- rising interest rates, government debt and budget deficits combining to increase the Government's interest expense; and
- poor expenditure control processes, particularly reflecting significant unfunded ad-hoc spending decisions outside the budget process.

The Medium Term Fiscal Strategy (MTFS)

The MTFS laid out a four point plan to put PNG's public finances on a sustainable footing, returning the Budget to balance by the end of the period.

1. Immediate cuts in discretionary expenditure in order to break the cycle of deficit and debt.
2. Systematic review of government expenditure to ensure limited resources are used effectively used in delivering public goods and services.
3. Structural improvements in government budget processes.
4. Putting in place the environment for sustained private sector economic growth.

The MTFS recognized that while in theory taxes could be increased to pay for additional expenditure, in practice this would damage the economy by discouraging those in the private sector who seek to work hard, invest and save.

Point 1 is the first phase of the MTFS, with points 2-4 constituting the second phase.

The objective of this plan was to have Budget balance each year no lower than the following over the medium term.

Year	Target Budget balance (% GDP)	Actual Budget Outcome (% GDP)
2003	- 1.7%	- 1.0%
2004	- 1.5%	+ 1.4%
2005	- 1.0%	
2006	- 0.6%	
2007	- 0.2%	
2008	Balance	

Fiscal Framework and Implementation Principles

The MTFS outlines key principles for the fiscal framework and implementation of the Government's Budgets.

Fiscal Framework principles

- Government will live within its means by producing a budget that is affordable and sustainable.
- Government will not add to debt in the medium term.
- Budgetary expenditures will be consistent with agreed national and sectoral priorities.
- Government will limit its participation to core areas where there is a clear rationale for public intervention.
- Government will provide a regulatory framework that encourages and supports the private sector.

Fiscal Implementation principles

- Government will exercise tight fiscal controls by closely monitoring all expenditures and by enhancing revenue collection.
- Budget plans will be adhered to and departments will be held responsible and accountable for managing their allocated expenditures.
- Government will ensure that any mid-year proposals outside the budgetary process will be required to identify funding options and compensating savings with the department or agency.
- Government will work towards increasing the transparency of public finances by the release of timely budgetary information.

Progress report on practical implementation of the MTFS

Phase One: Stabilisation

The first phase of the MTFS has been an unambiguous success.

With sustained effort, the Government has been successful in achieving actual budget outcomes better than the targets set in the MTFS.

- The 2003 Budget outcome was a deficit of 1.0 per cent of GDP, compared to the MTFS target of a deficit of 1.7 per cent of GDP.

- The 2004 Budget outcome was a **surplus** of 1.4 per cent of GDP, compared to the MTFS target of a deficit of 1.5 per cent of GDP.

The 2005 Budget outcome is currently projected to be better than the MTFS target.

With improved macroeconomic stability, the economy has returned to growth, the exchange rate has stabilized, and lower interest rates and public debt levels have seen a rapid fall in the government's interest expense.

Phase Two: Structural reform

We are now in the critical second phase of the MTFS.

There is still much work to be done.

Expenditure is still not as well directed as it could be, with too much allocated to non-priority areas and the money allocated to priority areas not being used as effectively as it could be (with too much spent on salaries and administration and not enough on service delivery).

The Government announced the Rightsizing policy initiative in the 2005 Budget.

The Rightsizing initiative is aimed at reviewing the functions, structure and resourcing of agencies to ensure priority functions are properly resourced and non-priority functions are not funded (or provided with lower funding relative to priority areas).

The Rightsizing review is currently underway, and recommendations will go to NEC in late July 2005, with those recommendations that are approved feeding into the 2006 Budget process.

While the environment for the private sector has improved, the Government remains committed to addressing serious structural impediments to the growth of the private sector.

**Economic Policy Division
Department of Treasury
July 2005**