

2008 NATIONAL BUDGET VOLUME 1

ECONOMIC AND DEVELOPMENT POLICIES

For the year ending 31st December, 2008

**Presented by
Hon. Patrick Pruaitch, MP
Minister for Treasury and Finance**

On the occasion of the Presentation of the 2008 National Budget



HON. PATRICK PRUAITCH, MP
MINISTER FOR TREASURY AND FINANCE

FOREWORD

The 2008 Budget has been put together against a backdrop of strong domestic economic growth. This is being supported by ongoing favourable international conditions with the commodity price boom continuing and widening to include stronger agricultural prices.

Economic growth forecasts for 2007 have been revised up to a strong 6.2 per cent. The upward revision is largely due to intense competition and increased coverage across the country in the mobile phone market which is providing significant social and economic benefits. Economic growth in 2008 is forecast to strengthen even further to 6.6 per cent. If the forecasts are realized, 2007 and 2008 together will represent the two strongest years of consecutive economic growth in the last 15 years.

Economic growth is also very broadly based across all sectors of the economy and across virtually all parts of the country. Businesses are becoming more confident about the economic outlook and are investing more heavily. More of our people are finding work in the growing formal economy which translates into financial support for multiples of people for each additional new job created. With economic growth now well above population growth, we should start to see a gradual improvement in the average living standards of the population.

The 2008 Budget uses the same prudent fiscal thinking that has been used in framing recent Supplementary and Annual Budgets. This involves windfall revenues associated with the commodity price boom being isolated from the recurrent budget and used in a one-off manner that will provide future benefits for both current and future generations. Such revenues have continued to be used for paying down Government debt and superannuation obligations and providing large amounts to be used over time for infrastructure rehabilitation and improvement across the country.

In addition, the 2008 Budget has also been guided by the development work behind the proposed *2008-2012 Medium Term Fiscal Strategy* which is nearing finalization. Economic growth and prudent fiscal settings have allowed an additional K300 million to be used in the 2008 recurrent budget. This is being used to again provide relief from school fees and to strengthen service delivery capability across the public sector and to extend educational, health and agricultural services. At the same time, the 2008 Budget eliminates some nuisance taxes for business and provides tax cuts for all individuals in manner that provides the greatest proportionate benefit to low income earners.

The 2008 Budget is about sustaining economic growth, strengthening our financial position and improving service delivery, thereby **empowering the people of Papua New Guinea**. The Budget seeks to spread the benefits arising from the commodity price boom right across the country. A key aspect of this Budget is the allocation of K534 million to the districts which comes on top of the K356 million already allocated to the districts in the 2007 Supplementary Budget. Taken together, this represents an enormous commitment by the Government to empower people at the district level to improve the basic services that they need. The provision of such large funds at the district level brings with it a corresponding increase in responsibility and accountability at the district level.

Including the funds for districts, the 2008 Budget provides over K1 billion for the maintenance, improvement and development of infrastructure right across the country. These funds will go into trust and will add to what will be a massive pool of funds held in trust until appropriate implementation plans are developed. Given the time that it takes to prepare and implement quality and effective investment plans, together with capacity constraints in both the public and private sectors, it will take a number of years for these projects to be implemented.

It will be helpful for assisting to maintain macroeconomic stability if the funds held in trust are spent gradually over time. This is because the actual spending of these large amounts of Government funds will provide a large economic stimulus into an environment of higher inflationary pressures and already strong investment by the private sector. Actual Government spending will therefore need to be monitored and controlled very carefully to ensure that it does not overheat the economy but helps to sustain growth and strengthen the economy. We will all need to display some patience and practical understanding in not expecting to see all these projects come to fruition into the near future.

The Government realizes that the economic progress that has been made needs to be sustained and strengthened through further structural reforms that will facilitate private sector growth. This includes undertaking critical public sector reforms, corporatizing state-owned enterprises, tackling land reform, conducting sectoral reviews, increasing competition in key sectors of the economy and removing impediments to business and investment.

While many challenges remain, we should not lose sight that some good gains have been made and we are now facing the future much more optimistically than many of us can remember. The 2008 Budget builds on the gains that have been made and sets a solid financial foundation for us to be confident about the future.

I commend the 2008 Budget to the Honourable members and the people of Papua New Guinea.

PATRICK PRUAITCH, MP
Minister for Treasury and Finance

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CHAPTER 1. ECONOMIC AND FISCAL DEVELOPMENTS IN 2006 AND 2007

1.1 OVERVIEW

The Papua New Guinea economy is growing at the strongest rate in over a decade, reflecting increased business confidence, higher employment growth, stronger investment and higher business profits. This improved economic growth picture stems from a combination of the commodity price boom arising from positive international developments, improved political stability, prudent macroeconomic and fiscal policies, together with low interest rates and inflation.

In 2006, Real Gross Domestic (GDP) growth slowed to an estimated 2.6 per cent, with non-mining GDP growing at 3.7 per cent. Lower than expected growth in 2006 reflected temporary interruptions to oil exports and poor seasonal conditions that reduced agricultural production. In 2007, a rebound in mineral production, better seasonal conditions, high commodity prices and strong growth in the non-mining sector is expected to see the economy grow by 6.2 per cent, with non-mining GDP growth expected to be slightly higher at 6.5 per cent. There are signs of strengthening across most sectors of the economy – growth is broadly based. 2007 represents the fifth successive year of real GDP growth that is now significantly above population growth, assisting to gradually improve the average standard of living.

Importantly, the Government is committed to maintaining and improving the medium-term policy framework which has been built up over recent years. Continued fiscal discipline, lower levels of Government debt, improved service delivery from some Government utilities and ongoing political stability are all contributing to a better outlook over the medium term.

Table 1: Principal Economic Indicators

	2004 Actual	2005 Actual	2006 Actual	2007 Proj
Real GDP Growth (%)	2.7*	3.4*	2.6*	6.2
Real Non-Mining GDP Growth (%)	3.1*	3.1*	3.7*	6.5
Employment Growth (%)	0.7	1.7	7.3	9.5
Inflation (year average) (%)	2.1	1.7	2.3	1.8
Treasury Bill rate (%)	9.0	4.5	5.0	5.0
3 year Inscribed Stock yield (%)			6.0	5.7
World Economic Growth (%)	5.3	4.8	5.4	5.2
Oil Price (US\$ per barrel)	42.1	53.4	64.3	67.3
Copper Price (US\$ per pound)	1.30	1.67	3.05	3.28

Sources: National Statistical Office, International Monetary Fund, Department of Treasury, Bank of Papua New Guinea.

* GDP data for 2004, 2005 and 2006 are Department of Treasury's estimates. Employment growth is the change in formal non-mining employment through-the-year.

Formal private sector employment is growing strongly, reflecting positive developments in the economy. In 2006, employment grew by 7.3 per cent in the non-mining sectors and by 9.5 per cent in the mining sector. Over the year to June 2007, employment in the non-mining and the mining sectors grew by around 9.5 per cent, with particularly strong growth coming from retail, building and construction, and agriculture, forestry and fisheries sectors.

Consumer prices increased by 2.3 per cent in 2006 in year-average terms, slightly higher than the previous year's inflation outcome – this largely reflected higher fuel, transport and communication and food prices. In 2007, the headline rise in inflation is expected to be 1.8 per cent, largely reflecting lower food prices, continued prudent fiscal management and moderate public sector wage outcomes.

However, higher inflationary pressures have emerged, with underlying inflation increasing by 6.5 per cent over the last year. The Government is very mindful of containing inflationary pressure by closely monitoring the impact of Government expenditure on demand pressures in the economy and with the Central Bank closely monitoring monetary policy to ensure price stability.

Interest rates have remained at historically low levels, reflecting subdued inflation outcomes. In 2006 and 2007, the Treasury Bill interest rate averaged around 5.0 per cent, below the Bank of Papua New Guinea's target rate (the Kina Facility Rate) of 6.0 per cent. Yields on 3 year Inscribed Stock (Government Bonds) have been around 6.0 per cent. The historically low interest rates have also been influenced by the high levels of liquidity that are in the system.

The exchange rate was relatively stable throughout most of 2006, but has depreciated significantly on an imported Trade Weighted Index (TWI) basis against major trading partner currencies (especially against the Australian dollar) over the last year. This depreciation of the Kina has seen the price of many imported goods rise. The value of the Kina against the United States dollar has appreciated slightly over the last two years.

Gross international reserves increased markedly in 2006 and have increased further to be over US\$1,800 million at the end of September 2007. This reflects the impact of the commodity price boom and is the strongest international reserves position experienced since Independence. This relatively high level of reserves is more than sufficient to perform the role of appropriately managing short-term exchange rate volatility.

1.2 GROSS DOMESTIC PRODUCT

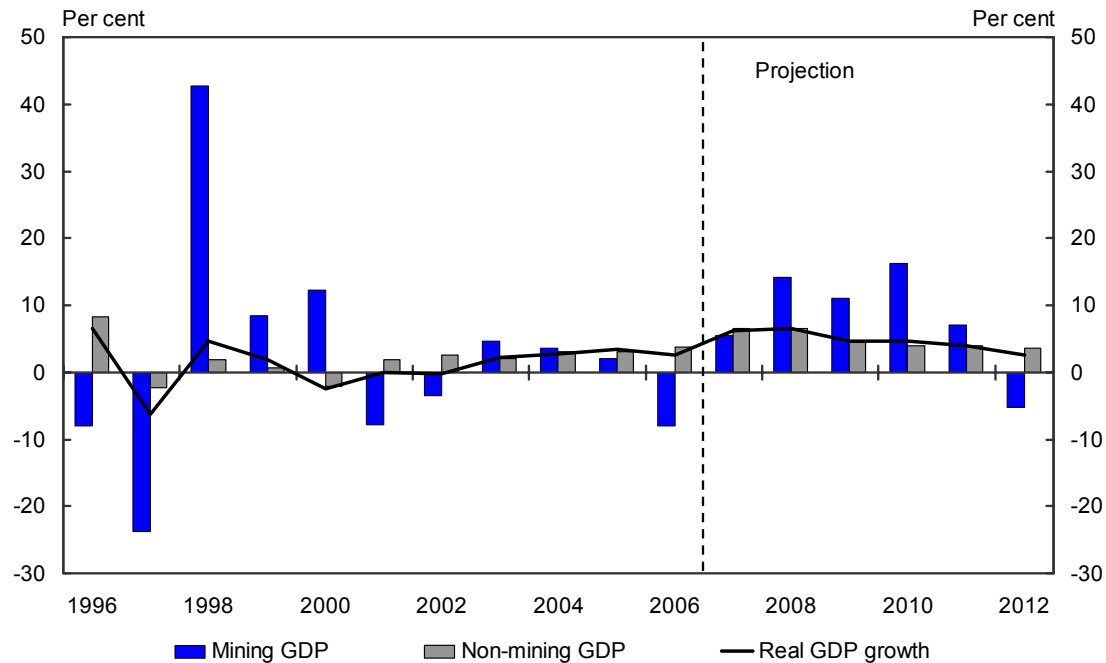
In 2006, real economic growth is estimated to have been 2.6 per cent, with the non-mining sector growing by 3.7 per cent in the year.

The oil and gas extraction sector is estimated to have declined slightly due to an oil spill that resulted in a one month shut down in operations at the Kumul terminal. In the absence of this shut down the oil and gas sector would have grown by around 5 per cent.

The mining and quarrying sector is estimated to have also declined, by 8.1 per cent in real terms in 2006. Output from Ok Tedi fell due to mining of low ore grades. Lihir mine ramped up production and continued to improve in line with its mine plan. For Porgera, 2006 was a disastrous year, with no output for almost three months as the main power supply from Hides was destroyed by lightning and continuous slips on the pit walls hindered production.

Output in the agriculture, forestry and fisheries sector grew moderately by 0.7 per cent in real terms in 2006. Cocoa recorded strong real growth of 8.5 per cent in 2006, while rubber and palm oil production grew by 3.0 per cent and 2.1 per cent in real terms respectively. Log exports grew strongly by more than 15.6 per cent in real terms in 2006. Most of the key agriculture commodities like copra, copra oil, and coffee experienced a huge decline in their production mainly due to the volcanic eruptions and unfavorable weather conditions in 2006.

The non-mining sector in 2006 grew strongly, driven by a buoyant construction sector which grew strongly by 12.0 per cent and supported by strong growth in the finance, real estate and the business sector with an 8.5 per cent growth in real terms. This was mainly driven by increased private sector investment in the mineral sector, in particular the new projects of Ramu nickel, Sinivit and Simberi mines.

Figure 1: Economic Growth: 1995 – 2012

Source: Department of Treasury

Real economic growth in 2007 is forecast to be the strongest in over a decade at 6.2 per cent, up from 2.6 per cent in 2006. Forecast GDP growth in 2007 has been revised up by one percentage point from the 5.2 per cent growth expected at the time the 2007 Mid Year Economic and Fiscal Outlook (MYEFO) report was prepared. This growth is broad based with strong growth in most sectors, including 35 per cent in communication, 14 per cent in building and construction and 3.7 per cent in agriculture. The major revision has been to the communication sector, due to the exceptionally large expansion in the mobile phone segment of the sector. This alone has added 0.9 percentage points to real GDP growth.

The commodity price boom has continued and strong global demand for PNG's major commodities has resulted in a significant increase in PNG's export prices from previously high levels, further strengthening PNG's favourable terms of trade. This is particularly the case for minerals such as copper, gold and oil where large increases in prices over the last few years have in some cases increased even further to reach record highs in 2007. At the same time, there are signs of an improvement in most sectors of the economy, especially in agriculture where commodity prices have also grown strongly. The fishery and forestry sectors have also boosted output, but the construction sector has experienced the strongest growth.

The strong terms of trade over recent years has influenced the economy largely through increased revenue collections by the Government. While part of that higher revenue is being used on debt repayment, there has been a significant increase in Government spending allocations to trust funds for future spending and some allocations have been actually spent. Despite the commodity price boom, monetary policy remains largely unchanged, with interest rates remaining at low levels, the money supply and credit growing strongly, and the exchange rate depreciating against most major trading partner currencies.

Several years of macroeconomic, fiscal and political stability has led to an increase in confidence in the domestic sector. More favourable economic conditions have encouraged substantial investments in both the mining and non-mining sectors, creating more employment, increasing business opportunities – this has all strengthened the economy.

The communication sector in particular has grown exceptionally strongly in response to microeconomic reform. This has allowed competition in the mobile phone sector, where the incumbent operator and new entrant have expanded operations. This has increased subscriber numbers substantially and has vastly contributed to the increased domestic activity in the economy.

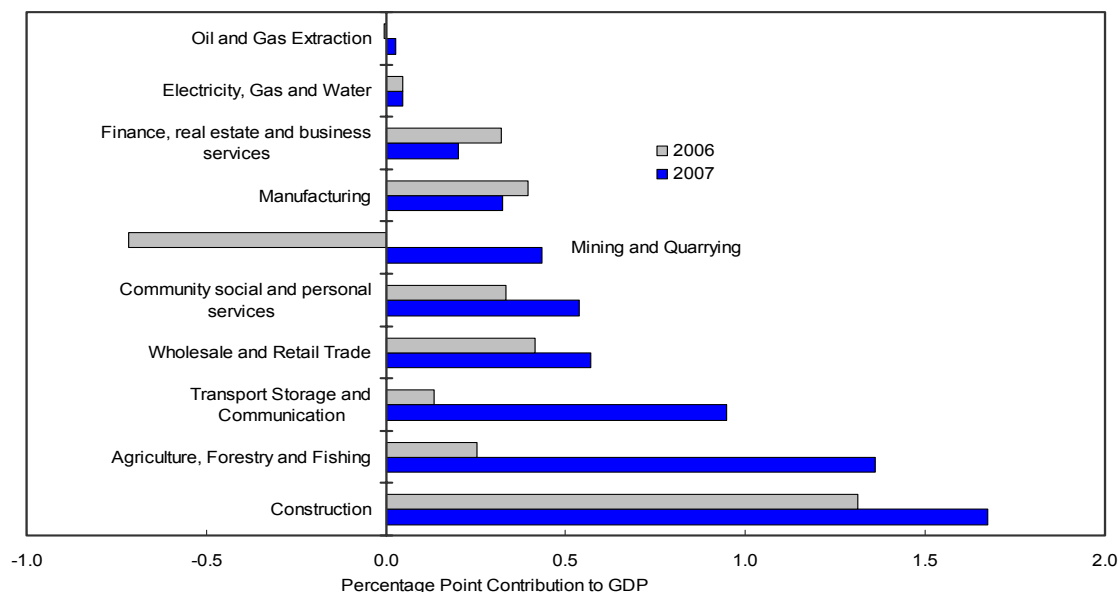
The oil and gas extraction sector is estimated to grow moderately by 0.9 per cent in real terms in 2007, which also reflects a natural decline from all the existing fields. The mining and quarrying sector is estimated to have increased by a robust 5.5 per cent in real terms in 2007, reflecting normal production from the existing mines and the inclusion of Simberi mine in the later part of the year. The Lihir and Porgera mines have ramped up production and continued to improve in line with their expansion plans, more than offsetting lower production from Ok Tedi and other smaller mines.

The agriculture, forestry and fisheries sector is expected to grow solidly by 3.7 per cent in real terms in 2007. The very strong performance of some key agriculture commodities in 2007 partly reflects recovery from large downturns in 2006. For example, copra is expected to record historically high growth of 82.8 per cent in 2007 following negative growth of 43.6 percent in 2006. Copra oil production is expected to rise by 32.5 per cent in 2007. Cocoa and coffee production are expected to grow well by 8.3 per cent and 6.2 per cent respectively in real terms, more than offsetting lower growth in the other sectors.

Log exports are expected to grow by a strong 7.1 per cent in real terms in 2007, reflecting higher production and export due to the inclusion of three new additional projects in the forestry sector that has come into operation; offsetting declining production from existing projects.

The non-mining sector of the economy is displaying robust real growth in 2007, driven by very high growth in construction, agriculture/forestry/fishery and the communication (especially mobile phone segment of the market) combined with solid growth in other sectors. Economic growth also reflects higher Government expenditure to improve and maintain public infrastructure, combined with increased private sector investment in the mineral sector, in particular, the new Ramu nickel project.

Figure 2: Contribution to Growth by Industry in 2006 and 2007

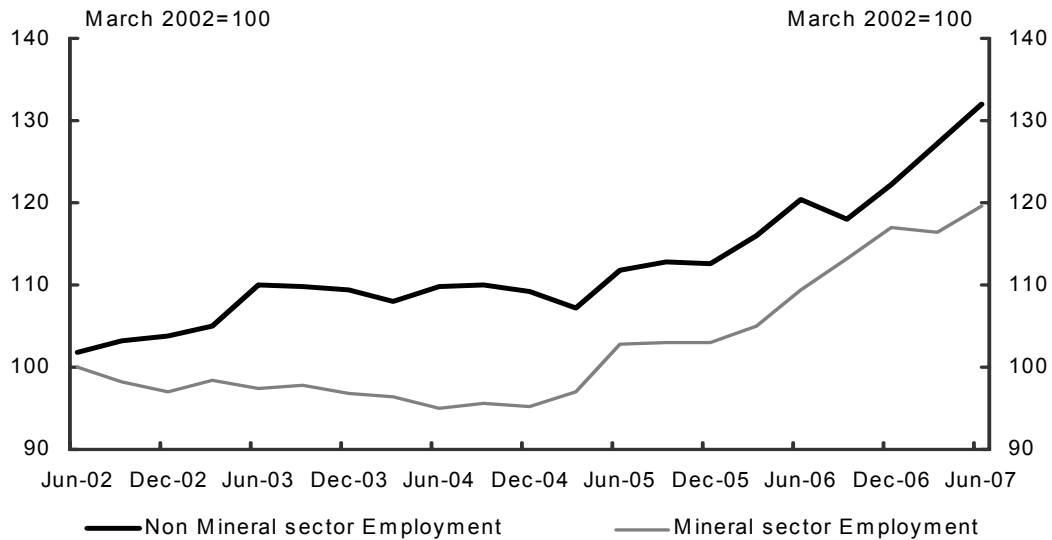


Source: Department of Treasury

1.3 LABOUR MARKET

Total non-mineral sector employment increased by 7.3 per cent in 2006 with strong growth in building and construction, wholesale and agriculture, forestry and fisheries sectors which more than offset lower employment in other non-mineral sectors. Employment in the mineral sector grew by 9.5 per cent in 2006.

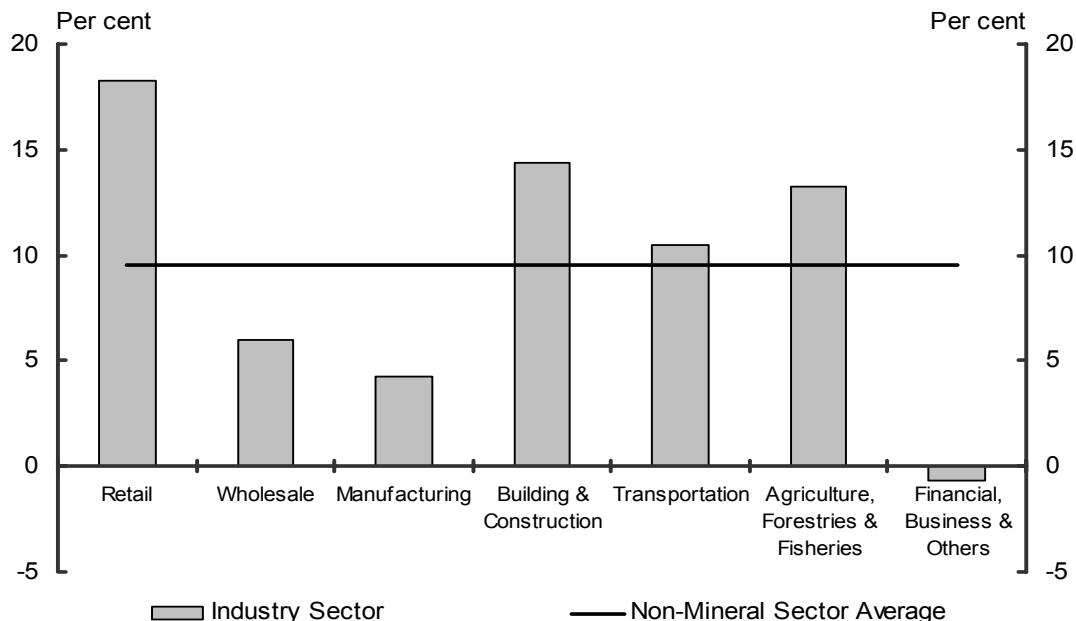
Figure 3: Index of Non-Mineral and Mineral Sector Employment



Source: BPNG

In the year to the June quarter 2007, total private non-mineral sector employment rose by 9.5 per cent, driven mainly by employment growth in retail, building and construction, agriculture, forestry and fisheries sectors. Employment in the mineral sector was also up in the June quarter of 2007, rising by a strong 9.4 per cent from a year earlier.

Figure 4: Employment Growth by Sector: June Quarter 2007



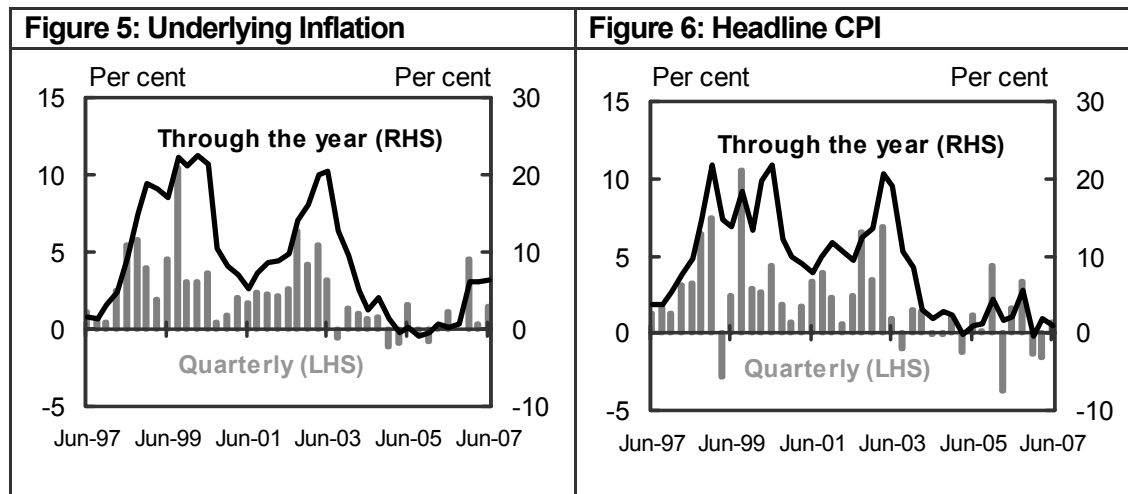
Source: BPNG

While the pace of regional employment growth has varied in 2007, all regions have showed good signs of employment growth with the Morobe and Momase regions recording the highest growth of 17.9 per cent and 13.3 per cent. This notable improvement in employment growth is due to stronger economic growth, which reflects a more conducive investment climate, sound macroeconomic policy and increased expenditure on improving and maintaining public infrastructure.

1.4 PRICES

Official inflation figures released in the June quarter 2007 Consumer Price Index (CPI) report shows that underlying inflation rose by 1.4 per cent in the quarter to be 6.5 per cent higher through the year. This was driven by increases in the price of miscellaneous items (largely medical and health care), food, clothing and footwear. The June quarter 2007 is the third consecutive quarter of large increases in the underlying CPI which increased by 3.8 per cent in the December quarter 2006 and 1.1 per cent in the March quarter 2007. This represents a significant rise in the underlying rate of inflation, being the highest annual rate since December 2003.

However, headline inflation which is typically more volatile than the underlying inflation measure increased by 0.7 per cent in the June quarter 2007 to be only 1.0 per cent higher through the year. The low increase in headline compared to underlying inflation is mainly due to a sharp decline in the prices of some food due to better seasonal conditions



Source: NSO, Department of Treasury

Annual inflation is expected to be 1.8 per cent in 2007 compared to 4.8 per cent forecast at the 2007 MYEFO. This is due to the significant downward revisions to recent historical figures that were contained in the June Quarter 2007 CPI release.

The Government is closely monitoring rising underlying inflationary pressures (see Box 1) that have emerged over the last year.

Box 1: Inflationary Pressures

The economy has experienced a major terms of trade shock arising from the international commodity price boom, with export prices increasing by 83 per cent since 2005. This is providing a great deal of stimulus to the economy, particularly through the budget. Since 2005, the growth in mineral receipts has increased substantially. This has led to two supplementary budgets in 2006 and one in 2007, with a total of K3.8 billion being allocated for eventual spending in the economy.

While most of this is in trust funds and is yet to be actually spent, it has and will represent a substantial injection of funds into the economy. While some of this spending will be on domestic goods and services, a large portion of it will also be on imported goods and services required for improving infrastructure. Spending on imports will help to alleviate upward pressure on domestic prices, but the impact of Government expenditure on domestic prices will need to be carefully monitored.

Despite the commodity price boom, monetary policy has remained essentially unchanged. Interest rates have remained very low since 2005 and liquidity continues to build up in the economy. Currency in circulation grew by a worrying 35 per cent in the year to August 2007, with wider money supply measures growing by 23 per cent over the same period. Lending across all sectors of the economy also grew strongly by 35 per cent in the year to June 2007. Sustained growth of monetary aggregates of this magnitude is likely to result in further inflation – the Central Bank needs to be ready to respond to these risks.

Turning to the exchange rate, while the Kina has appreciated slightly against the US\$ over the past year, it has depreciated significantly against a number of other major currencies, such as the Australian dollar, Euro and Singapore dollar. These currencies represent PNG's major sources of imports, resulting in a 8 per cent

depreciation of the import weighted Trade Weighted Index (TWI) over the year to October 2007. This depreciation of the Kina is increasing the price of imported goods.

However there are some other deflationary factors that are assisting to reduce prices in some areas. The expansion and competition in the domestic mobile phone market and the falling prices of durable goods imported from East Asia are reducing prices in some areas of the economy.

With the entry of a new foreign firm, Digicel, in the mobile phone market, competition in the mobile phone market has greatly intensified reducing the price of mobile phone services to consumers. Furthermore, with the current expansion in the sector from both the incumbent and its competitor, low prices are expected to spread across the country including the rural areas.

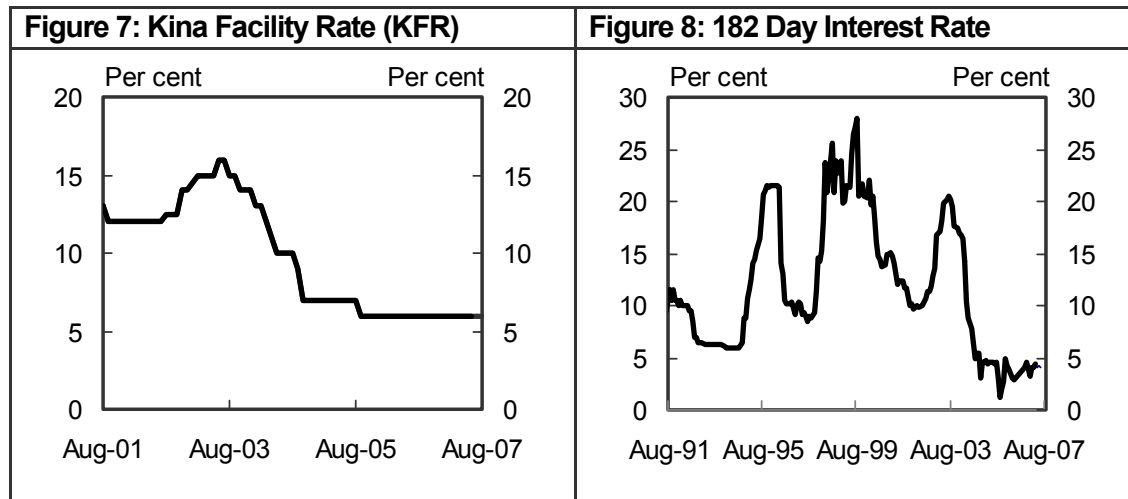
While recent measures of the headline inflation rate are low, this is reflecting seasonal influences on food prices. The rise in underlying inflation rate is more indicative of the growing inflationary pressures in the economy.

Overall, there are significant risks to inflation on the upside. The economy is currently in the midst of a terms of trade boom which has increased money supply and allowed the Government to increase spending. At the same time, the private sector is also expanding strongly into an economy that is facing significant capacity constraints. In addition, the Kina has depreciated against most other major trading partners, notably against the Australian dollar our major Trading Partner – this is placing upward pressure on the prices of imported goods.

In this environment, the monetary policy stance and Government spending needs to be closely monitored to ensure it remains appropriate for the circumstances faced.

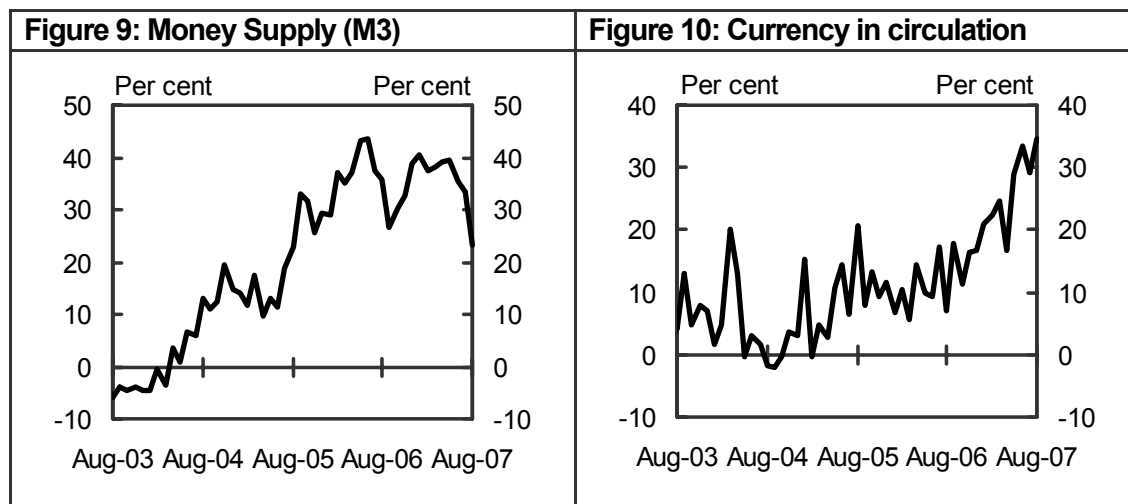
1.5 MONETARY DEVELOPMENTS

The Kina Facility Rate has remained unchanged at 6 per cent since 2005. Market interest rates have remained lower over the same period, with the 182 day Treasury bill down by 0.47 percentage points to 4.0 per cent at June 2007. This is below the Central Bank's benchmark rate of 6 per cent which reflects the high levels of liquidity in the system.



Source: BPNG

Total money supply has continued to increase strongly in 2006 and 2007, increasing by 36 per cent in 2006 and by a further 23 per cent in the year to August 2007, although growth rates appear to be easing. On the other hand, currency in circulation has grown by a worrying 35 per cent over the year to August 2007 and appears to be on an upward trend.



Source: BPNG

Lending from the commercial banks to business has also increased strongly, growing by 35.1 per cent through the year to June 2007. At the same time, business deposits with commercial banks have also increased, growing from K2994.6 million in June 2006 to K3900.2 million in June 2007, an increase of K905.6 million. This strong growth in lending and deposits reflects higher domestic activity across all sectors of the economy, particularly in business like hotels and real estate. Bank margins between average interest rates on deposits and loans remain high.

1.6 BALANCE OF PAYMENTS AND INTERNATIONAL RESERVES

In 2007, the current account balance is expected to be a surplus of K802 (4.3 per cent of GDP), which is K453 million lower than the 2006 surplus of K1,255 million. The lower surplus reflects higher imports, which increased by more than exports.

In the first half of 2007, the current account balance recorded a surplus of K304 million, which is lower than the surplus of K1,059 million recorded in the corresponding period of 2006.

The value of exports in 2007 is expected to increase by 14.4 per cent from 2006, reflecting increased volumes of exports of both agriculture and mineral exports due to a pick up in production and higher world prices of the bulk of PNG's exports.

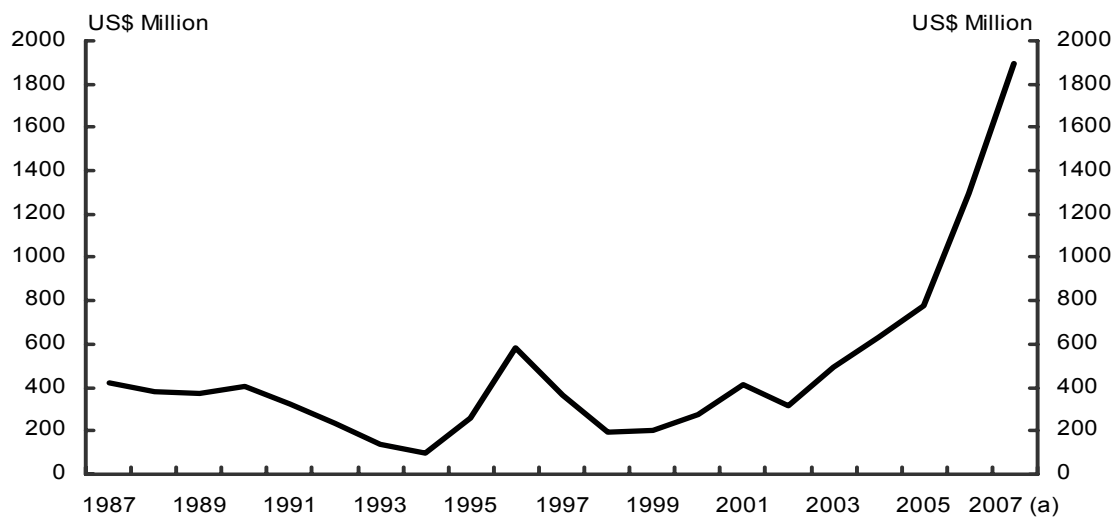
The value of imports is expected to increase by 26.7 per cent in 2007, mainly reflecting stronger investment and economic growth. There are also large amounts of capital goods imports for the Ramu Nickel mine and other new projects. Also, there are expected to be increases in services imports, as well as higher transfer payments abroad.

In the Income and Transfers balance, it is expected that there will be increased inflows reflecting increased donor funds and grants. However, it is also expected that there will be higher income outflow in 2007 outweighing inflows, due to higher revenues and very strong profits of mineral producers.

The Capital and Financial Accounts recorded a deficit of K304 million in the first half of 2007. This implies a net outflow of capital from the PNG economy, which has largely taken the form of a build up in foreign reserves which has increased by K394.7 million in the first half of 2007. In the full year of 2007, the capital and financial accounts is expected to record a deficit of K802 million, lower than the deficit of K1,239 million in 2006.

The holdings of gold and foreign exchange reserves by BPNG at the end of September 2007 were K5,500 million (US\$1,897.8 million). This very high level of reserves is more than sufficient to perform the role of managing short term exchange rate volatility.

Figure 11: Foreign Reserves (US Dollar Millions)



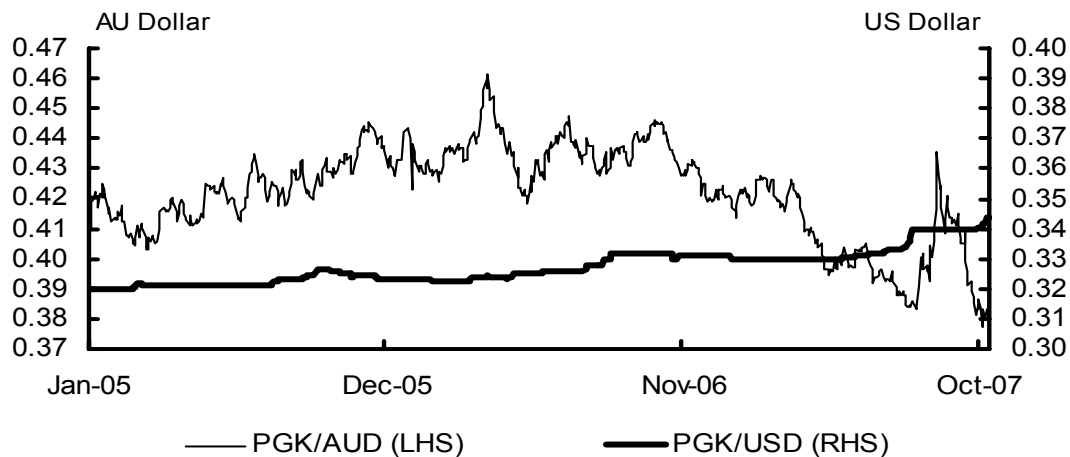
Source: BPNG

(a) Includes reserve levels to end of September, 2007.

1.7 EXCHANGE RATE DEVELOPMENTS

The exchange rate was relatively stable throughout most of 2006, but has depreciated significantly on an imported Trade Weighted Index (TWI) basis against major trading partner currencies over the last year. This is especially the case against the Australian dollar, with the Kina losing 13 per cent of its value against the Australian dollar over the last year. This depreciation of the Kina has seen the price of many imported goods rise, especially as over 50 per cent of imports come from Australia. The value of the Kina against the United States dollar has appreciated slightly by 7 per cent over the last two years. However, given the substantial weakening of United States dollar against most other currencies over this period, the Kina's gain has been very modest.

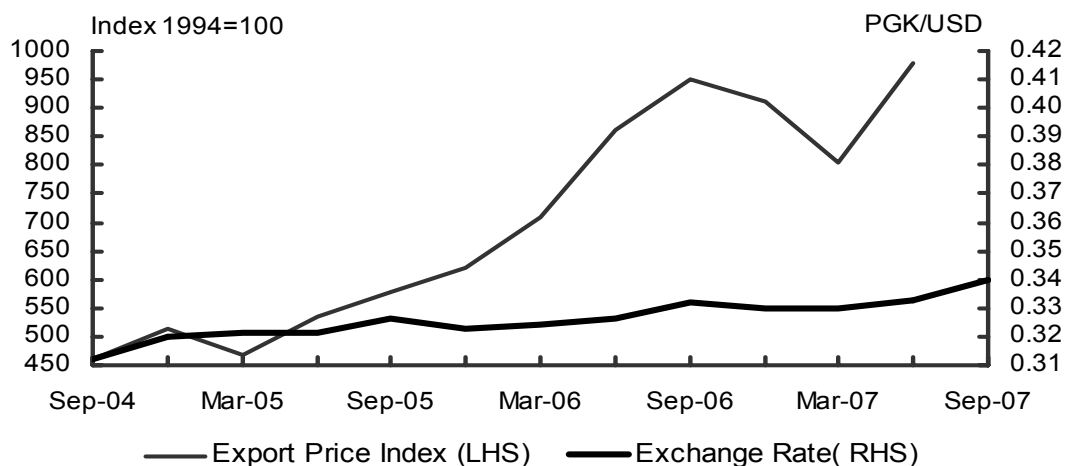
Figure 12: Exchange Rate Developments



Source: BPNG

Exchange rate movements over the last two years do not reflect the massive increase of 83 per cent in the terms of trade that have occurred over this period, or the strong increase in international reserves. Over the last year the Kina has depreciated against the Pound Sterling and the euro by 4 and 7 per cent respectively, however, the Kina appreciated by 1.1 per cent against the Japanese Yen.

Figure 13: Export Price Index and Exchange Rate Movements



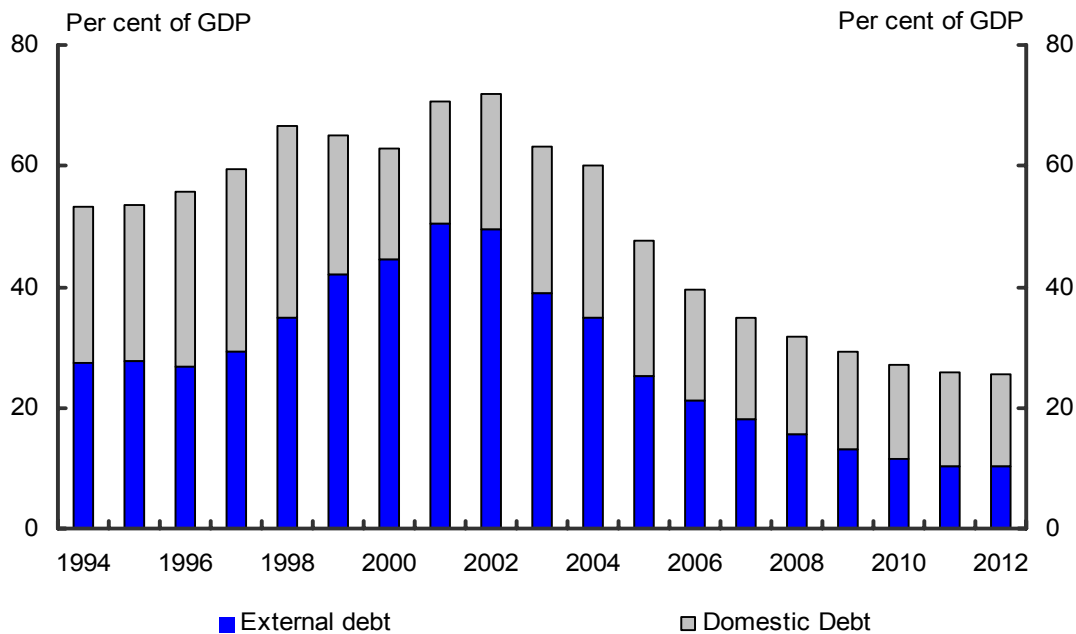
Source: BPNG

1.8 PUBLIC DEBT

Total Public debt has fallen from 72. per cent of GDP or K8,365.3 million in 2002 to 39.5 per cent of GDP or K6,732.1 million at the end of 2006. By the end of 2007, total public debt is expected to fall to 34.9 per cent of GDP or K6,472.5 million. This reflects a combination of robust GDP growth and continued repayment of Government debt.

Over the 5 years to 2007, the debt to GDP ratio has more than halved and is approaching what is considered to be a more sustainable level. This represents an impressive improvement for PNG that is freeing up resources within the Budget and reducing vulnerabilities to any adverse economic/financial developments.

Figure 14: Public Debt 1994-2012



Source: BPNG and Department of Treasury

1.8.1 Domestic Debt

At the end of 2006 the stock of domestic debt was K3,101.0 million, a decrease of K302.8 million or 9 per cent over a year earlier. The stock of total domestic debt at the end of 2007 is expected to be K3,135.1 million, an increase of K34.1 million or 1.1 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 composition of domestic debt since 2005 has continued to change, with domestic debt in 2007 expected to be comprised of 29.8 per cent Treasury Bills, 69.6 per cent Inscribe Stock and 0.6 per cent Other Domestic Loans.

1.8.2 External Debt

Total external debt at the end of 2006 was K3, 631.1 million. This represented a decline of K224.9 million or 5.8 per cent from the level at the end of 2005. This decline in external debt has continued in 2007 falling by 8.1 percent or K293.8 million to a projected K3,337.3 million by year end.

The decline in external loans reflects the Government's strategy of increasing the percentage of debt issued domestically, thereby reducing the percentage share of external or foreign currency debt.

Project loan draw downs are expected to be K163 million in 2007 while principal repayments of external debt is estimated to be K518 million.

External debt continues to be dominated by debts to international agencies (multilateral and bilateral creditors) accounting for 96.6 per cent of external debts as at year- end 2006, with commercial loans accounting for the remaining 3.4 per cent.

1.9 CENTRAL GOVERNMENT FISCAL OPERATIONS

The fiscal outcome for 2007 is now projected to be a budget surplus of K321.1 million, or 1.7 per cent of GDP, compared with the original deficit estimate of K35 million or 0.2 per cent of GDP.

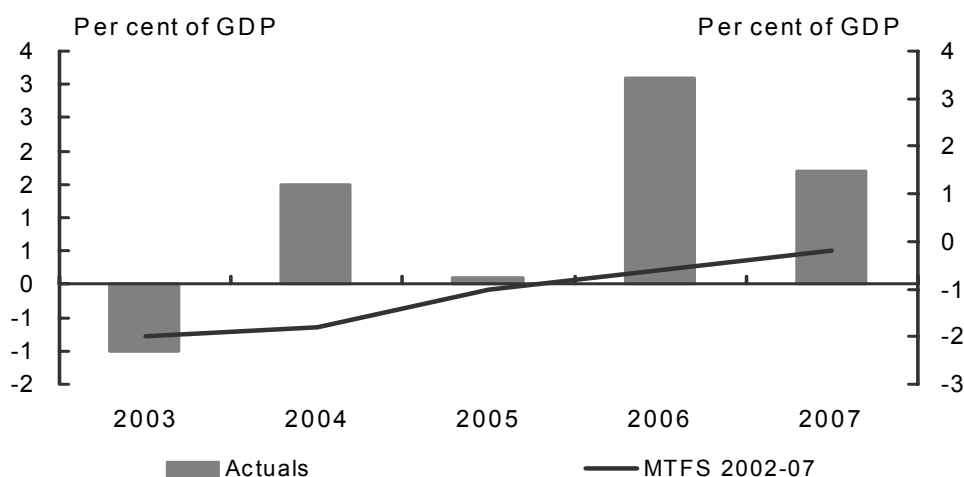
Table 2: Budget Balance 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Total Revenue and Grants	6311.6	5421.6	7199.6	+1778.0
Total Expenditure and Net Lending	5775.8	5456.6	6878.6	+1422.0
Deficit (-)/Surplus(+)	535.8	-35.0	321.0	+356.0
Per cent of GDP	3.1%	-0.2%	1.7%	+1.9

Source: Department of Treasury

Over the term of the Medium Term Fiscal Strategy (MTFS) 2002-2007, the fiscal performance has been better than that targeted under the Strategy. See Figure 15 below.

Figure 15: Actual Budget Balance and the MTFS Target



Source: Department of Treasury

1.9.1 Total Revenue and Grants

Total Revenue and Grants for 2007 are estimated to be K7,199.6 million, an increase of K1,778 million or 32.8 per cent from the 2007 Budget projection of K5,421.6 million.

Table 3: Tax Revenue 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Taxes on Income and Profits	3823.5	3071.6	4386.9	+1315.3
Dom. Taxes on Goods & Services	784.3	758.0	940.3	+182.3
Taxes on International Trade	337.0	300.3	366.3	+66.0
Tax Revenue	4944.8	4129.9	5693.4	1563.5

Source: Department of Treasury

Tax revenue is now expected to be K5,693.4 million in 2007, K1,563.5 million or 37.9 per cent higher in 2007 than the Budget projection of K4,129.9 million. The increase in tax revenue largely reflects substantially higher than expected taxes on income and profits.

Table 4: Taxes on Income and Profits 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Personal Income Tax	907.0	890.3	994.1	+103.8
Company Tax	550.6	511.7	633.2	+121.5
Dividend Withholding Tax	200.9	168.1	183.3	+15.2
Mining and Petroleum Taxes	1946.5	1292.8	2362.0	+1069.2
Interest Withholding Taxes	22.1	21.9	19.4	-2.5
Other Direct Tax	92.4	80.8	95.2	+14.4
Gaming Tax	104.0	106.0	99.6	-6.4
Taxes on Income and Profits	3823.5	3071.6	4386.9	+1315.3

Source: Department of Treasury

Tax on income and profits is now expected to be K4,386.9 million in 2007, K1,315.3 million or 42.8 per cent higher than expected in the 2007 Budget. This increase largely reflects higher mining and petroleum taxes due to higher-than-expected world prices for PNG's major mineral commodity exports (see Box 2) and an increase in share of oil production subject to income tax. The resultant increased profitability in the mining and petroleum sector has also been reflected in dividend withholding tax collections, which is now expected to be K183.3 million in 2007, up by K15.2 million from the estimate in the 2007 Budget.

Personal income tax is expected to increase by K103.8 million over the 2007 Budget estimate to K994.1 million in 2007, mainly due to the late payment of an installment due in December 2006. Company tax collections were stronger than expected at the time of the 2007 Budget, reflecting an increase in economic activity and profitability for businesses.

Other direct taxes in 2007 are now expected to be K14.4 million more than originally forecast, primarily reflecting stamp duty on a share transfer in the middle of the year. On the other hand, interest withholding tax will be lower than originally forecast in 2006 as interest rates have remained lower than expected and gaming tax is expected to come in lower due to the National Government's share of tax rates reduced from 79 per cent to 49 per cent.

Box 2: Commodity Prices

Movements in commodity prices – particularly of oil, copper and gold – and in the exchange rate can have large effects on the Government's revenue through mining and petroleum taxes, dividend withholding tax and mining dividend payments.

Variations in commodity prices and exchange rates have separate effects on revenue. Higher commodity prices will result in more revenue, while a higher exchange rate will result in less revenue.

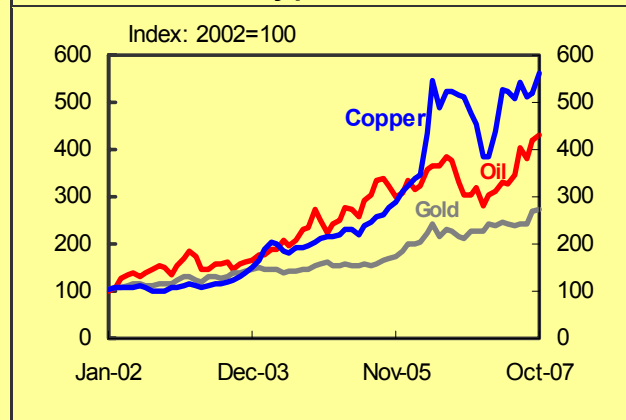
PNG's exchange rate may move in line with commodity-price changes, which would cause an offset to the effects on revenue of the commodity price changes. But this cannot be relied upon. In the last few years, while commodity prices have strengthened, the Bank of Papua New Guinea has built up its foreign currency reserves and the appreciation of the Kina against the US\$ has been only slight.

In 2008, the Government expects to collect almost K2.5 billion in mineral and oil revenues – more than 40 per cent of total revenue. This is based on year average price assumptions of US\$61.9 per barrel for oil, US\$5,400 per tonne for copper, US\$662 per troy ounce for gold, and an exchange rate of US\$0.34.

These price assumptions are broadly in line with IMF projections. They are well below the current record high market prices, but for good reasons. High commodity prices have been accompanied by increased volatility. Since the beginning of 2006, oil and copper prices have shifted by more than 20 per cent on at least six occasions, with some of these movements taking place over less than a week – as the accompanying chart shows.

Because of this volatility, and the way mineral and oil taxes are assessed, the outlook for revenue can change quickly and by large amounts during a year. The sharp falls recorded in early 2007 illustrate this— oil and copper prices fell to US\$52 per barrel and US\$5,100 per tonne well below the prices assumed in the 2007 Budget. If these prices

had continued for the rest of 2007, the fiscal scenario would have looked markedly different.

Commodity prices, 2002-2007

Given the great difficulty of predicting commodity prices or exchange rate movements, the Government has been careful to use prudent price assumptions. Doing this is in line with IMF advice and the budgeting practice of most other mineral producing countries. However, the Government has also been careful not to use artificially low price assumptions, unlike a number of other countries, where oil price assumptions used for budgetary purposes have been as low as US\$20 per barrel.

Given the prudent assumptions, there is a reasonable chance that commodity prices may come in above the Budget assumptions in 2008. However the consequences of this happening are far less than if prices were to fall below, which would result in a revenue shortfall. It is easier to allocate additional revenue than it is to cut planned expenditure.

The possibility of mineral revenue coming in above the Budget forecast creates challenges for the annual Budgetary process. An expectation that there will always be more money available than contained in the Budget encourages over-spending and the making of spending commitments outside the Budget process.

These practices should be avoided because they weaken the discipline on Government agencies to stay within their Budget allocations, and allow second-best uses of Budget resources.

Part of the answer is to develop a prioritized program of investment projects over the medium term, which can be funded if and when additional revenue is

received and as implementation capacity develops in the public and private sectors. Such a program would be a key input in the event of future Supplementary Budgets.

Given the volatility and uncertainty of commodity prices, some information is provided in the table below about how variations in commodity prices or the exchange rate may affect Government revenue.

The table shows estimates of the changes in revenue which would result if there were different year average commodity prices or exchange rates.

It should be remembered that there is a range of other factors that can also affect mineral and oil revenues, including unforeseen shutdowns, the mining of lower ore grades, project costs, capital expenditures, landowner disputes, changes to dividend policy and timing of MPT payments by producers. Therefore these estimates should be used only as a guide.

Sensitivity of revenues to commodity price and exchange rate assumptions

Variation Per cent	Price	Total Revenue Kina Million	Variation from Budget Kina Million
Oil			
30	\$80 per barrel	6402.5	398.3
15	\$71 per barrel	6203.4	199.1
Budget	\$62 per barrel	6004.3	0.0
-15	\$53 per barrel	5805.1	-199.1
-30	\$43 per barrel	5623.0	-381.3
Copper			
30	\$7020/tonnes	6368.1	363.9
15	\$6210/tonnes	6186.2	181.9
Budget	\$5400/tonnes	6004.3	0.0
-15	\$4590/tonnes	5822.3	-181.9
-30	\$3780/tonnes	5640.4	-363.9
Gold			
30	US\$861/troy ounce	6271.0	266.7
15	US\$762/troy ounce	6138.0	133.7
Budget	US\$662/troy ounce	6004.3	0.0
-15	US\$563/troy ounce	5871.0	-133.3
-30	US\$464/troy ounce	5737.0	-267.3
Combined effects of oil, gold and copper price variations			
30		7033.0	1028.7
15		6518.0	513.7
Budget		6004.3	0.0
-15		5490.0	-514.3
-30		4992.0	-1012.3
Exchange rate (Kina/US\$)			
30	0.442	5340.0	-664.3
15	0.391	5629.0	-375.3
Budget	0.340	6004.3	0.0
-15	0.289	6512.0	507.7
-30	0.238	7238.0	1233.7

Table 5: Domestic Taxes on Goods and Services 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Excise	324.1	309.8	335.8	+26.0
GST	401.1	420.0	554.3	+134.3
Mining Levy	56.1	25.6	48.0	+22.4
Other Indirect	3.0	2.6	2.2	-0.4
Domestic Taxes on Goods & Services	784.3	758.0	940.3	+182.3

Source: Department of Treasury

Domestic taxes on goods and services are now expected to be K940.3 million in 2007, K182.3 million higher than forecast in the 2007 Budget. Domestic excise revenue collections are expected to be better than previously forecast reflecting increased domestic production of refined petroleum products at the Napa Napa Oil Refinery.

GST is also expected to be significantly stronger than forecast in line with the stronger-than-expected growth in domestic demand.

Table 6: Taxes on International Trade 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Import Duty	90.4	96.9	124.2	+27.3
Export Duty	162.6	118.0	152.6	+34.6
Excise Duty on Imports	84.0	85.4	89.4	+4.0
Taxes on International Trade	337.0	300.3	366.3	+66.0

Source: Department of Treasury

Taxes on international trade are now projected to be K366.3 million in 2007, which is K66.0 million or 22 per cent more than originally expected. Import duty will raise K27.3 million more than expected. This is due to the 2006 outcome being stronger than expected and stronger than expected domestic demand resulting in higher imports.

Export duty on logs is expected to be K152.6 million in 2007, up K34.6 million from the 2007 Budget estimate. The main driver is the higher production of logs in early 2007 as a result of better seasonal conditions and high international prices compared to the expectations at the time of the 2007 Budget.

Excise duty on imports are now expected to be K89.4 million in 2007, which is K4.0 million higher than originally expected. This reflects the greater than expected rise in domestic production of refined petroleum products at the Napa Napa Oil Refinery.

Table 7: Non-Tax Revenue 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Property Income	339.3	242.8	375.2	+132.4
<i>Non-Mining Dividends</i>	68.1	73.5	73.5	+0.0
<i>Mining & Petroleum Dividends</i>	271.2	169.3	301.7	+132.4
Interest and Fees from Lending	0.6	2.6	2.6	+0.0
Other Non Tax Revenue	88.9	81.8	82.0	+0.2
Non Tax Revenue	428.8	327.2	459.8	+132.6

Source: Department of Treasury

Non-tax revenue is estimated to be K132.6 million, or 40.5 per cent, higher in 2007 than expected at the time of the 2007 Budget.

The increase is primarily attributable to higher than anticipated mining and petroleum dividend receipts. In particular, the sharp increase in the world price for copper in 2007 has resulted in much higher than expected dividends from the State's share in the Ok Tedi mine. In addition, the State's interest in the Moran oil field – held through the Mineral Resources Development Corporation – has now been fully paid, with dividends in respect of this interest commencing in 2006.

The Bank of Papua New Guinea paid the State its dividend in 2007 which was K33 million in relation to its 2006 operating profit. National Fisheries also paid K10 million in dividends.

While dividends should also be received in 2007 from the Independent Public Business Corporation (IPBC), these amounts tend to be received relatively late in the year and are among the most difficult of revenue items to predict.

Interest and fees from lending, departmental revenue, and infrastructure tax credits, and project support grants are expected to be the same as forecast in the 2007 Budget.

Grants are anticipated to be K1,013.4 million in 2007 and Infrastructure Tax Credits is anticipated at K33 million.

1.9.2 Total Expenditure and Net Lending

Total Expenditure and Net Lending in 2007 is now projected to be K6,878.6 million, an increase of K1,422.0 million or 26 per cent on the 2007 Budget estimate of K5,456.6 million.

In 2007, the Government continued to deliver on its track record of restraining spending to limits in Budget Appropriation Acts. While expenditure in 2007 is substantially over the original budget appropriation, this reflected the Government's decision to apply stronger than expected revenue to priority expenditure areas through the 2007 Supplementary Appropriation Act, rather than a loss of expenditure control or fiscal discipline

Table 8: Total Expenditure and Net Lending 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Recurrent Expenditure	3014.7	3370.0	3370.2	0.2
Development Expenditure	1554.1	1636.6	1718.4	+81.8
Additional Priority Expenditure	1207.0	450.0	1790.0	+1340
Total Expenditure and Net Lending	5775.8	5456.6	6878.6	+1422.0

Source: Department of Treasury

1.9.2.1 Recurrent Expenditure

The overall recurrent expenditure in 2007 is estimated to be K3,370.2 million, reflecting estimated low interest payments due to low interest rates.

Table 9: Recurrent Expenditure 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Personal Emoluments	1360.5	1392.2	1424.2	+32.0
Goods and Services	1070.5	1233.5	1304.5	+71.0
Interest Payments and Fees	307.0	475.9	372.9	-103.0
Transfers to Bougainville	46.5	50.7	50.9	+0.2
Transfers to Statutory Institutions	234.3	221.6	221.6	0.0
Net Lending to CSAs	-4.2	-4.0	-4.0	0.0
Total Recurrent Expenditure	3014.6	3370.0	3370.2	+0.2

Source: Department of Treasury

The 2007 Budget provided K20.0 million for urgent unanticipated expenditure in 2007. In addition, K115.4 million was reallocated through Secretary's Advance, sourced from anticipated under spends in certain appropriations. Table 10 outlines the re-allocation of these funds.

**Table 10: Allocation of funds from the Secretary's Advance in 2007
(Kina Millions)**

Total Available for Allocation	135.4
<i>Original Balance 2007 Budget</i>	<i>20.0</i>
<i>Savings</i>	<i>115.4</i>
Natural Disaster	3.5
National Road Authority Maintenance	10.0
Retrenchment	36.9
Interest Savings – Treasury Bills	25.0
Interest Savings – Inscribed Stocks	40.0
Additional Expenditure	135.0
<i>Urgent Unanticipated Items</i>	<i>123.5</i>
Security for National Election (Defence & CS allowances)	7.8
Newcastle Disease	2.8
Deputy Prime Minister's Office	0.3
Consultancy payments	0.8
Manam Resettlement Authority	2.0
National Housing Policy Task Force	0.5
Lawsuit in New York	1.0
Education Subsidies	100.0
Retrenchment payments	4.1
Fire Emergency Services	0.6
FIFA Presidential visit	0.3
Others	0.3
<i>Items Overlooked in the 2006 Budget</i>	<i>2.5</i>
Financial Management Implementation Program	2.5
<i>Outstanding Obligations (including Compensation Payments)</i>	<i>2.5</i>
Peace Negotiation	0.2
Land Rental Payment (Jackson)	0.5
Customary Land purchase (Governor General House)	0.7
Power Bill payments	0.3
ICT Policy Task Force	0.5
Social Economic Implementation	0.3
<i>Investigations</i>	<i>5.9</i>
Finance Investigation	4.3
Pacific Balance Fund Investigation	1.0
Defence Force Investigation	0.6
<i>Additional Vehicles</i>	<i>0.2</i>
Replacement of Trade & Commerce Secretary's official	0.2
<i>Donations</i>	<i>0.5</i>
Disaster Relief for Solomon Islands	0.5
Closing Balance as at MYEFO 31 July 2007	0.4

Source: Department of Treasury

1.9.2.2 Development Expenditure

Development expenditure in 2007 is expected to remain within the original 2007 Appropriation, except for development items in the additional appropriations in 2007 and increase in donor grants mainly from Australia.

Table 11: Development Expenditure 2006 – 2007 (Kina Millions)

	2006 Actual	2007 Budget	2007 Revised	Change
Domestic Financing	471.2	509.1	509.1	0.0
Grants	914.6	879.1	1013.4	+134.3
Infrastructure Tax Credits	23.3	85.4	33.0	-52.4
Concessional Loans	145.0	163.0	163.0	0.0
Total Development	1554.1	1636.6	1718.4	+81.8

Source: Department of Treasury

1.9.2.3 2007 Supplementary Budget

With the continuous sustained high prices on world markets for our main mineral commodities (oil, copper and gold), an additional K1,637.0 million has been allocated to priority areas. This is in addition to the K450 million Additional Priority Expenditure.

Table 12: Additional Priority Appropriation: 2007 Supplementary Budget (Kina Millions)

Items	Total
Recurrent Expenditure	197.0
NADP	40.0
CAA Restructuring	21.0
Secretary's Advance	20.0
Election cost overruns	15.0
SSG	15.0
Doctors Back Payment of S&W	10.0
Cocoa Pod and Coffee Borer Measures	12.0
Defence Uniforms and re-instated staff	8.0
Outstanding Legal Fees	8.0
Court Orders	8.5
Natural Disaster Fund	7.0
Maritime Boundary Project	5.0
Others	27.5
Public Infrastructure	537.0
Major Infrastructure Maintenance	257.0
Infrastructure Maintenance in Health	80.0
Infrastructure Maintenance in Education	80.0
Infrastructure Maintenance in Justice	80.0
Housing and Urbanisation	40.0
District Service Improvement Project	356.0
K4.0 million each District	356.0
Retiring Public Debt	297.0
Nambawan Super	250.0
GRAND TOTAL	1637.0

Source: Department of Treasury

In line with the Medium Term Fiscal Strategy 2002-2007 and the MTDS 2005-10, the items in the 2007 Supplementary Budget fall into three broad categories: investments in economic impact programs under the recurrent budget, public infrastructure maintenance and improvement, and to paying down Government debt and other one-off outstanding obligations.

As in 2006, in keeping with the Government's commitment to fiscal responsibility, as outlined in the *Fiscal Responsibility Act* 2006, the Government will not spend temporary windfall revenues on items that would place unsustainable pressure on future budgets.

The 2007 Supplementary Budget puts the Medium Term Development Strategy into action and reflects the Government's commitment to provide funding directly to the district level, to ensure that service delivery reaches the majority of the people in the rural areas.

In line with the guidelines established for the implementation of the Additional Priority Appropriation, funds will be disbursed, monitored, accounted for and reported on accordingly; to ensure that maximum benefits is gained on the intended purpose of appropriation.

1.9.3 Financing

A fiscal surplus of K321.0 million or 1.7 per cent of GDP is now expected in 2007, compared with the original budget deficit estimate of K35.0 million or 0.2 per cent of GDP.

The fiscal surplus will be used to retire debt, resulting in an expected net external outflow of K355.0 million and a net increase in domestic financing of K34.0 million. This compares with the net domestic financing requirement of K34 million for 2007.

CHAPTER 2 2008 BUDGET

2.1 OVERVIEW

The economy is growing at the fastest rate in over a decade and growth is expected to increase further in 2008, underpinned by strong global conditions, increased domestic business and consumer confidence and political stability. Inflation is low, although inflationary pressures are rising. Interest rates remain low and the exchange rate is expected to remain stable over the course of the year. The economy is expected to grow significantly by 6.2 per cent in 2007 and with robust domestic and external economic conditions expected to continue plus fiscal discipline being maintained, economic growth should continue to be strong in 2008.

Table 13: Key Economic Assumptions 2006 – 2008

	2006	2007	2008
	Actual	Revised	Projection
Real GDP Growth	2.6	6.2	6.6
Real Non-Mining GDP Growth	3.7	6.5	6.5
Inflation (year average)	2.3	1.8	5.2
Oil Price (USD/Barrel)	64.3	67.3	61.9
Copper Price (USD/Pound)	3.05	3.28	2.45
Interest Rates (Treasury Bills)	5.0	5.0	6.0

Source: Department of Treasury and NSO

The 2008 Budget is built on the strong foundation of the Government's prudent fiscal management and economic growth strategy, and is designed to enhance and promote a dynamic and competitive private sector. It will again use the additional revenue associated with high commodity prices to improve PNG's long-term welfare, while keeping ongoing expenditure at a level sustainable in the medium term.

The Medium Term Development Strategy 2005-2010 (MTDS) sets out the Government's medium-term development priorities, and it is reflected in the priorities for expenditure in the 2008 Budget.

Table 14: Budget Balance 2006 - 2008 (Kina Millions)

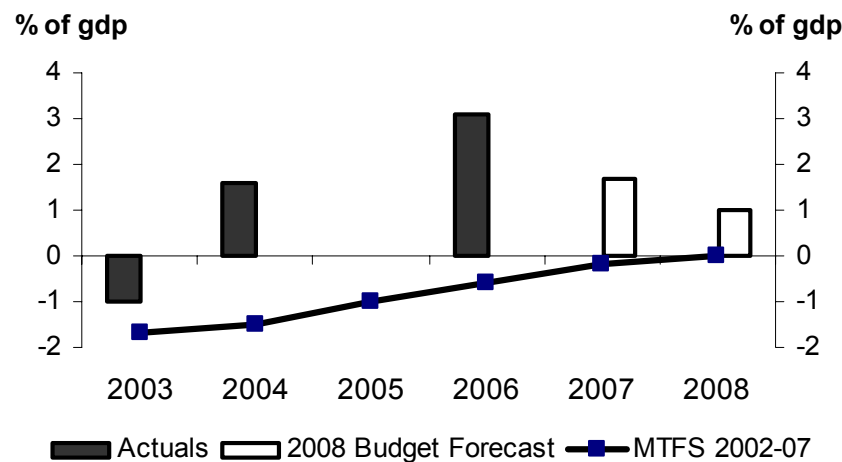
	2006	2007	2008	Change
	Actual	Revised	Projection	
Total Revenue and Grants	6311.6	7199.6	7201.7	+2.1
Total Expenditure and Net Lending	5775.8	6878.6	6999.4	+120.8
Budget Balance	535.8	321.0	202.3	-118.7
Per cent of GDP	3.1	1.7	1.0	-0.7

Source: Department of Treasury

2.2 FISCAL STRATEGY

The 2008 Budget is the new Government's first annual budget following the 2007 General Elections. It is framed in an environment of political and economic stability which allows policies to be set confidently within medium-term frameworks.

The current Medium Term Fiscal Strategy (MTFS) is for 2002–2007 and expires at the end of 2007. Fiscal outcomes over the life of the MTFS have been significantly better than the targets that were set in the MTFS (see Figure 16).

Figure 16: Actual Budget Balances and MTFS Targets

Source: Department of Treasury

The changed situation of high commodity prices and unusual levels of mineral revenue calls for a different fiscal strategy. Department of Treasury has prepared a proposed new MTFS for 2008-2012, and the 2008 Budget is set within it. A summary of the proposed new MTFS is provided in Chapter 9. Its major principles are:

- ongoing spending will not exceed the amount of revenue that can be relied upon in the absence of a commodity price boom, which includes a component of mineral revenue equal to 4.0 per cent of GDP;
- additional revenue will be allocated flexibly between public investment and debt/liability repayment, depending on implementation capacity and the requirements of demand management;
- as an upper bound, the Government will not increase the overall level of public debt during its term, applying the principle in the *Fiscal Responsibility Act, 2006*; and
- because it is desirable to end the period with the State's finances stronger than they are now, the MTFS includes a guideline of using additional mineral revenue in the proportions of 60 per cent public investment and 40 per cent debt/liability repayment.

The 2008 Budget has a strategy which is based on this in two main ways.

- First, it relies on expected mineral revenue only up to an amount equal to 4 per cent of GDP for funding ongoing spending.
- Secondly, it forecasts an overall budget surplus of K202.3 million or 1.0 per cent of GDP, which is the result of an allocation of additional mineral revenue between a range of public investments and two kinds of debt/liability repayment.

More broadly, the strategic purposes of the 2008 Budget reflect the guiding principles for the formulation and implementation of the Budget in the Fiscal Responsibility Act 2006, which are reproduced in Box 3.

Box 3: Budget Guiding Principles

The Budget preparation is underpinned by a number of medium-term guiding principles:

Framework:

- Government will live within its means by producing a budget that is affordable and sustainable.
- Government will maintain the integrity of the tax system.
- Government will not raise the overall level of debt during its term.
- The budget will be in balance over the term of the Government.
- 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.

Implementation:

- 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 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 releasing timely budgetary information.

The fiscal year 2008, is expected to be the fourth consecutive year of unusually large mineral revenues as a result of continued high commodity prices. The Government has grasped the opportunity which this presents in formulating the 2008 Budget. It has chosen ways of adding to ongoing expenditure, and ways of allocating additional mineral revenue, which should help to improve the future delivery of goods and services, and thereby ***“empower the people of Papua New Guinea”***.

At the same time, the Government is maintaining its commitment to prudent fiscal management.

- It is limiting the increase in ongoing spending to what can be sustained for the rest of the five years ahead.
- It is taking care to ensure that the allocation of additional mineral revenue does not result in unsustainable additions to future years' recurrent and development spending.

- It is including a further large reduction in the State's liability for public servants' superannuation, and a substantial safety margin of planned debt repayment.

As in 2007, the key focus of expenditure in 2008 is to increase the proportion of the Budget allocated to the seven priority areas identified in the *Medium Term Development Strategy* (MTDS). The 2008 Budget Strategy Paper set a target of achieving at least 53 per cent of total (GoPNG) Budget expenditure being allocated to MTDS priority areas, with at least 88.5 per cent of (GoPNG) Development Budget expenditure being allocated to MTDS priorities.

Rather than leave some key development tasks solely to donors, the 2008 Budget continues to ensure a reasonable allocation of the Government's own resources to these development priorities. This allows clear signals to be sent to donors and civil society that PNG's development should be driven according to the Government's policy framework and development strategy – in line with the Government's goal of working towards economic independence.

The 2008 Budget is based on the existing tax structure and does not propose any new taxes or tax increases. This follows the scheduled tax reforms in personal income tax, the phasing out of the mining levy and the tariff reduction program that have been completed. To complement efforts on the expenditure side of the Budget to improve the state of public infrastructure and service delivery, the Government is removing minor taxes which are considered as impediments to business and investment, and providing some tax relief to all personal income tax payers.

2.3 REVENUE AND GRANTS

The 2008 Budget honors the Government's existing commitments to continue improving the tax system by removing taxes that are considered as impediments to business.

Further, the Government will also continue to focus on improving the level of compliance with the taxation laws, thereby ensuring that everyone pays their fair share of tax.

Table 15: Revenue and Grants 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Tax Revenue	4944.8	5693.4	5516.8	-176.6
Non-tax Revenue	428.8	459.8	487.5	27.7
Infrastructure Tax Credits	23.3	33.0	73.7	40.7
Project Support Grants	914.6	1013.4	1123.7	110.3
Total Revenue and Grants	6311.6	7199.6	7201.7	2.1

Source: Department of Treasury

Total Revenue and Grants are projected to be K7,201.7 million in 2008, a decline of K2.1 million (or around 1.3 per cent) from the estimated level for 2007. This mainly reflects expected reductions in tax revenues from the mineral sector.

2.3.1 Tax Revenue

Tax revenue is projected to decrease by K176.6 million (or 3.1 per cent) to K5,516.8 million in 2008, compared with the K5,693.4 million estimated in 2007.

Table 16: Tax Revenue 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Taxes on income and Profits	3823.5	4386.9	4142.0	-244.9
Dom. Taxes on Goods & Services	784.3	940.3	987.3	47.0
Taxes on International Trade	337.0	366.3	387.4	21.1
Tax Revenue	4944.8	5693.4	5516.8	-176.6

Source: Department of Treasury

This reflects an expected K244.9 million (or 5.6 per cent) decline in Taxes on Income and Profits along with a K21.1 million (or 5.8 per cent) increase in Taxes on International Trade and K47 million (or 5.0 per cent) increase in Domestic Taxes on Goods and Services.

Table 17: Taxes on Income and Profits 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Personal Income Tax	907.0	994.1	1053.7	59.6
Company Tax	550.6	633.2	699.7	66.5
Dividend Withholding Tax	200.9	183.3	195.5	12.2
Mining and Petroleum Tax	1946.5	2362.0	2011.8	-350.2
Interest Withholding Taxes	22.1	19.4	21.4	2.0
Other Direct Tax	92.4	95.2	73.4	-21.8
Gaming Tax	104.0	99.6	86.5	-13.1
Taxes on Income and Profits	3823.5	4386.9	4142.0	-244.9

Source: Department of Treasury

Taxes on Income and Profits are expected to be K4,142 million in 2008, which is K244.8 million lower than the revised estimate of K4,386.9 million for 2007. The primary reason for this is an expected decline in tax revenues from the minerals sector in 2008.

Personal Income Tax receipts are expected to increase by K59.6 million (or 6.0 per cent) to K1,053.7 million in 2008 compared with the estimate of K994.1 million in 2007. This increase reflects the combined growth in employment and salaries, which offsets the cost of reducing the lowest marginal tax rate, and increasing the lowest threshold.

Corporate Income Tax receipts are estimated to increase by K66.5 million (or 10.5 per cent) to K699.7 million in 2008, compared with K633.2 million estimated in 2007. The increase in corporate income tax reflects expected solid economic conditions resulting in continued improvements in corporate profitability.

Dividend Withholding Tax collections are expected to increase by K12.2 million (or 6.7 per cent) to K195.5 million from the 2007 estimate of K183.3 million. The projected increase largely reflects the higher dividend receipts from Ok Tedi assumed in 2008, reflecting high international copper prices.

Mining and Petroleum Tax revenues are projected to fall by K350.2 million (or 14.8 per cent) to K2,011.8 million in 2008 against the 2007 estimate of K2,362.0 million. Major contributing factors to this projection include an assumed reduction in commodity prices and a moderate reduction in oil production.

Interest Withholding Tax receipts are projected to increase by K2.0 million (or 10.3 per cent) to K21.4 million in 2008 compared with K19.4 million estimated in 2007. The increase reflects the projected moderate rise in interest rates in 2008.

Other Direct Tax receipts are expected to decline by K21.8 million (or 23.0 per cent) to K73.4 million from K95.2 million estimated in 2007. This decline is due to the receipt in mid 2007 of stamp duty from an asset transfer as well as the abolition of a number of stamp duties, as described in Chapter 4.

Gaming Tax is projected to decline by K13.1 million (or 13.2 per cent) to K86.5 million in 2008 compared with K99.6 million estimated in 2007. This decline is a result of a decision to reduce the Government's share of revenue and to increase the return to site owners.

Table 18: Domestic Taxes on Goods & Services 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Excise	324.1	335.8	368.3	32.5
GST	401.1	554.3	600.8	46.5
Mining Levy	56.1	48.0	15.0	-33.0
Other Indirect	3.0	2.2	3.2	1.0
Domestic Taxes on Goods & Services	784.3	940.3	987.3	47.0

Source: Department of Treasury

Domestic Taxes on Goods and Services are expected to increase by K47 million (or 5.0 per cent) in 2008 to K987.3 million compared with K940.3 million estimated in 2007.

Domestic excise collections are expected to increase by K32.5 million (or 9.7 per cent) to K368.3 million in 2008 compared with the estimate of K335.8 million in 2007. This reflects continued strong domestic demand.

The National Government's share of Goods and Services Tax (GST) is expected to increase by K46.5 million (or 8.4 per cent) to K600.8 million in 2008 compared with the estimate of K554.3 million in 2007.

Mining Levy collections are expected to decline by K33 million to K15 million in 2008 compared with the 2007 estimate of K48 million. The mining levy will be completely phased out in 2008, however a number of arrears payments are expected, resulting in the collection of K15 million.

Table 19: Taxes on International Trade 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Import Duty	90.4	124.2	132.7	8.5
Export Duty	162.6	152.6	155.2	2.6
Excise Duty on Imports	84.0	89.4	99.5	10.1
Taxes on International Trade	337.0	366.3	387.4	21.1

Source: Department of Treasury

Collections from Taxes on International Trade are expected to increase by K21.1 million (or 5.8 per cent) in 2008 to K387.4 million compared with the 2007 estimate of K366.3 million.

Import Duty receipts are expected to increase by K8.5 million (or 6.8 per cent) to K132.7 million in 2008 compared to the 2007 estimate of K124.2 million, in line with increased economic activity.

Export Duty on logs is projected to increase by K2.6 million (or 1.7 per cent) to K155.2 million in 2008 compared with the 2007 estimate of K152.6 million, reflecting a slight increase in price projection offsetting the impact of the proposed reforms to forestry revenue sharing arrangements.

Excise Duty on Imports is projected to increase by K10.1 million (or 11.3 per cent) to K99.5 million in 2008 compared with an estimated K89.4 million in 2007, consistent with continued improved economic conditions.

2.3.2 Non-Tax Revenue

Table 20: Non Tax Revenue 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Property Income	339.3	375.2	388.3	13.1
<i>Non-Mining Dividends</i>	68.1	73.5	128.5	55.0
<i>Mining & Petroleum</i>	271.2	301.7	259.8	-41.9
Interest & Fees from Lending	0.6	2.6	5.0	2.4
Other Non Tax Revenue	88.9	82.0	94.2	12.2
Non Tax Revenue	428.8	459.8	487.5	27.7

Source: Department of Treasury

Non-Tax Revenue receipts are projected to increase by K27.7 million (or 6.0 per cent) in 2008 to K487.5 million compared with an estimated K459.8 million in 2007.

Property Income is projected to decline by K13.1 million (or 3.5 per cent) to K388.3 million in 2008 compared with the 2007 estimate of K375.2 million. The decline in property income is due largely to a projected reduced dividend from the State's 15 per cent interest in the Ok Tedi mine, reflecting an assumed reduction in the world price of copper.

The projection for non-mining dividends assumes the receipt of dividends in 2008 from the Bank of Papua New Guinea (K80 million), National Fisheries Authority (K23.5 million) and the Independent Public Business Corporation (K25 million). Mining and Petroleum dividends include an estimated dividend from the Mineral Resources Development Company (MRDC) in respect of the State's interest in the Moran joint venture.

Other Non-Tax Revenue, reflecting revenue from departments, is projected to increase by K12.2 million to K94.2 million in 2008 from the K82 million estimated for 2007. The increase in Other Non-Tax Revenue partly reflects the fact that the Government will continue to enhance effective monitoring and compliance to ensure improved collection in 2008.

2.3.3 Infrastructure Tax Credits

Infrastructure tax credits are expected to rise from K33 million in 2007 to K73.7 million in 2008. The projected increase reflects an assumed greater utilization of the tax credit system by mining and petroleum companies in 2008.

2.3.4 Grants

Project Support Grants for 2008 are expected to increase by K110.3 million to K1,123.7 million from the estimated level of K1,013.4 million in 2007. This is mainly because of an increase in grants from Australia and the European Union.

Table 21: Grants by Source 2007 – 2008 (Kina Millions)

	2007 Estimate	2008 Projection	Change
AusAid	736.0	791.0	55.0
JICA	43.8	31.7	-12.1
European Union (EU)	120.6	212.8	92.3
New Zealand	35.7	49.6	14.0
United Nations (UN)	25.9	0.0	-25.9
Others	54.1	38.5	-12.9
Total Project Grants	1013.4	1123.7	110.3

Source: Department of National Planning and Monitoring

2.4 EXPENDITURE

2.4.1 Additions to recurrent expenditure

In forming the 2008 Budget, the Government considered that:

- given Department of Treasury's revenue forecasts and the framework in the proposed new Medium Term Fiscal Strategy, it would be prudent to add a maximum of K300 million to ongoing spending in 2008, above the ceilings determined at the time of the Budget Strategy Paper in May 2007;
- on the basis of advice from the Budget Screening Committee and the Central Agencies Coordinating Committee, a range of additions to individual agencies' allocations was justified, compared with their ceilings;
- other additions to recurrent expenditure would be made so as to honour pre-election commitments of the Government, and to begin improvements in education and health services which the Government intends to continue through the next five years; and
- there would be scope also to provide ongoing tax relief both for businesses and for personal income tax payers, as an alternative to spending under the ceiling of K300 million.

On this basis, the Government has decided to allocate the K300 million in the following manner, for additional recurrent funding and for tax relief:

- | | |
|--|--------------|
| • Increases in agencies' allocations | K105 million |
| • Top-up funds for National Agriculture Development Plan | K 28 million |
| • Education subsidy | K100 million |
| • Expansion of education services | K 10 million |
| • Improving hospital services | K 10 million |
| • Reducing tax impediments for business | K 14 million |
| • Personal income tax relief | K 33 million |

2.4.1.1 Increases in Government agencies' allocations

As was recommended by the Budget Screening Committee and the Central Agencies Coordinating Committee, recurrent and development expenditures are to be increased by K105 million compared with the ceilings determined at the time of the Budget Strategy Paper in May 2007. This additional funding will assist public sector agencies — national departments, provinces and Budget-funded statutory authorities — to fulfill their roles and improve their delivery of services.

2.4.1.2 National Agriculture Development Plan

The Government plans to spend K100 million each year to implement the National Agriculture Development Plan. Because there are unspent funds in the relevant trust account, a top-up of K28 million is being provided in the 2008 Budget so that K100 million will be available in 2008.

2.4.1.3 Education

The Government early in 2007 announced a K100 million subsidy of school fees in this year, and undertook to continue this subsidy if possible. The 2008 Budget provides K100 million for the subsidy of school fees in 2008, and an additional K10 million intended to be the first of a series of annual increases which will provide for the expansion of education services.

2.4.1.4 Hospital services

An additional K10 million is being provided for improving hospital services. This is expected to assist with training of medical staff, supplies for hospitals and aid posts, and medical equipment – areas where there is a great need. This amount, like that for education, is intended to be the first of a series of annual increases.

2.4.1.5 Tax relief for business

In order to reduce impediments to doing business, the Government is abolishing stamp duties on borrowings, bills of lading, incorporations of companies, and insurance policies. In addition, the Government will abolish the debits tax, which is currently collected from banks as a small charge on every debit they process – this will benefit businesses and other bank customers as well.

These measures will have a cost to revenue of about K14 million in 2008, and about K20 million in 2009 when they have their full-year effect.

2.4.1.6 Tax relief for personal income tax payers

The 2008 Budget also provides significant tax cuts for all those who pay personal income tax. Relief will be provided from 1 January 2008, through a rise in the tax-free threshold from K6,600 to K7,000 and through lowering the initial tax rate (applying to taxable income between K7,000 and K18,000) from 25 per cent to 22 per cent.

These tax cuts will provide the greatest proportionate tax relief to low income earners. The cuts will mean an extra K430 per year after tax for people who earn K18,000 or more each year. The personal income tax cuts have an estimated cost to revenue of K33 million in 2008.

2.4.2 Recurrent Expenditure

Total Expenditure and Net Lending is projected to be K6,999.4 million in 2008, which is K120.8 million (or 1.8 per cent) higher than the expected 2007 Budget outcome. This is consistent with the Government's 2008 Budget surplus of K202.3 million, which is 1 per cent of GDP.

Table 22: Total Expenditure and Net Lending 2006 – 2008 (Kina Millions)

	2006	2007	2008	Change
	Actual	Estimate	Projection	
Recurrent Expenditure	3014.7	3370.2	3636.3	+266.1
Development Expenditure	1554.1	1718.4	1887.1	+168.7
Additional Priority Expenditure	1207.0	1790.0	1476.0	-314.0
Total Expenditure and Net Lending	5775.8	6878.6	6999.4	+120.8

Source: Department of Treasury

2.4.2.1 Recurrent Expenditure

Total Recurrent Expenditure in 2008 is estimated to be K3,636.3 million, which is K266.1 million (or 7.9 per cent) higher than the revised estimate for 2007. Total Recurrent Expenditure in 2008 is 51.9 per cent of Total Expenditure and Net Lending and 18.4 per cent of GDP.

Table 23: Recurrent Expenditure: By Item: 2006 – 2008 (Kina Millions)

	2006	2007	2008	Change
	Actual	Estimate	Projection	
Personal Emoluments	1360.5	1424.2	1528.9	+104.7
Goods and Services	1070.5	1304.5	1457.1	+152.6
ABG	46.5	50.9	54.0	+3.1
Transfers to Statutory Institutions	234.3	221.6	226.8	+5.2
Interest Payments and Fees	307.0	372.9	373.5	+0.6
Net Lending to CSAs	-4.2	-4.0	-4.0	0.0
Total Recurrent Expenditure	3014.7	3370.2	3636.3	+266.1

Source: Department of Treasury

2.4.2.2 Personal Emoluments

Personal emoluments is comprised of salary and allowances, wages, overtime, leave fares, superannuation contributions, superannuation payouts, and contract gratuities. Personal Emoluments for the National Departments and Provincial Governments, including teachers, are estimated to increase by K107.5 million (or by 7.4 per cent) to K1,565.4 million in 2008.

There are several factors behind the significant expected increase in personal emolument expenditure in 2008:

- Increase in school teacher numbers in line with population growth;
- Increase in staffing and industrial awards for health officers for the Hospital Management Services;
- Increase in staffing for the Department of Health;
- Increase in staffing and outstanding leave fares and entitlements for the Department of Works and Implementation;
- Increase in police personnel and PBSS payments for the Department of Police;
- Higher Government superannuation contributions in line with higher salaries;
- Increase in staffing for various agencies; and
- Provisional allocation for the pay agreement with the PEA.

These factors more than offset savings from the retrenchment of unattached officers in various agencies such as Departments of Corrective Institutional Services, Defence and Provincial Government Departments.

The Government has deferred consideration of the recommendations of the report of the Rightsizing Committee. Accordingly, the recommendations of the report have not been factored into the 2008 Budget estimates for personal emoluments.

Table 24: Personal Emoluments 2006 – 2008 (Kina Millions)

	2006	2007	2008	Change
	Actual	Estimate	Projection	
National Departments*	698.0	848.2	932.1	+83.9
Provincial Government	191.3	156.4	166.3	+9.9
Teachers	471.2	419.6	430.5	+10.9
Bougainville Government	28.9	33.7	36.0	+2.3
Total Personal Emoluments	1389.4	1457.9	1565.4	+107.5

Source: Department of Treasury

*Includes provisions for superannuation contributions and retirement payments.

A summary of the components of personal emoluments is provided in Table 25.

The superannuation contribution rate in 2008 remains the same at 6.3 per cent of salary in 2007 as the Government progresses towards full funding of superannuation contribution of 8.4 per cent of salary for Government employees in 2009.

The rapid growth in contract gratuity payments, which is estimated to increase by K38.4 million to K106.1 million in 2008, is due to increased employment contracts.

Table 25: Personal Emoluments By Item 2006 – 2008 (Kina Millions)

	2006	2007	2008	Change
	Actual	Estimate	Projection	
Salaries and Wages	1166.9	1180.6	1238.8	+58.2
<i>Salaries & Allowances</i>	<i>1073.1</i>	<i>1113.3</i>	<i>1164.4</i>	<i>+51.1</i>
<i>Wages</i>	<i>93.8</i>	<i>67.3</i>	<i>74.4</i>	<i>+7.1</i>
Superannuation	108.0	130.9	136.0	+5.1
Leave Fares	74.9	56.1	61.9	+5.8
Contract Gratuity	35.4	67.7	106.1	+38.4
Other*	4.2	22.6	22.6	0.0
Total Personal Emoluments	1389.4	1457.9	1565.4	+107.5

Source: Department of Treasury

*Includes overtime and contract officer education benefits.

2.4.2.3 Goods and Services

Total Goods and Services expenditure in 2008 is estimated to be K1,475 million. This is K153.5 million (or 11.6 per cent) higher than the revised estimate for 2007. The National Departments, Provincial Governments and Bougainville Government's goods and services expenditures are expected to increase by K146.3 million (or 12.4 per cent), K6.2 million (or 5.1 per cent) and K1 million (or 6.5 per cent) respectively.

Table 26: Goods and Services 2006 – 2008 (Kina Millions)

	2006	2007	2008	Change
	Actual	Estimate	Projection	
National Departments	967.9	1183.9	1330.2	+146.3
Provincial Governments	102.6	120.6	126.8	+6.2
Bougainville Government	13.5	17.0	18.0	+1.0
Total Goods and Services	1084.0	1321.5	1475.0	+153.5

Source: Department of Treasury

2.4.2.4 Goods and Services: National Departments

Total National Departments' Goods and Services provision is estimated to be K1,330.2 million in 2008, which is K146.3 million (or 12.4 per cent) higher than the revised estimate for 2007.

Table 27: National Dept. Goods & Services 2006 – 2008 (Kina Millions)

	2006	2007	2008	Change
	Actual	Estimate	Projection	
General Goods and Services	786.6	919.3	1079.3	+160.0
Education Subsidies	42.4	143.0	143.0	0
Other Goods and Services	138.9	121.6	107.9	-13.7
<i>Pre-March 2003 Arrears</i>	33.9	0.0	0.0	0.0
<i>Structural Adjustment Program</i>	30.3	69.6	55.9	-13.7
<i>Court Orders</i>	74.7	52.0	52.0	0.0
Total Goods and Services	967.9	1183.9	1330.2	+146.3

Source: Department of Treasury

General Goods and Services expenditure by National Departments is estimated to be K1079.3 million in 2008, an increase of K160 million (or 17.4 per cent) compared with the revised estimate for 2007. The net increase is mainly due to the increased allocation to various departments, particularly Departments of Health, Foreign Affairs and Trade, Hospital Management Services, Attorney General, Police, Corrective Institutional Services, Defence, Judiciary, Prime Minister and NEC and Information Technology Division.

Other goods and services expenditure in 2008 is estimated at K107.9 million, K13.7 million lower than the revised estimate for 2007.

The Budget continues to face pressure from the awarding of significant damages against the State. The 2008 Budget allocates K52 million for payment of court orders, with payments continuing to be made in line with the established 'aged basis' process and the interest cost incurred for late payment.

In the Structural Adjustment Program funding is allocated for retrenchment programs and programs supporting the Government's expenditure control measures and structural reform agenda.

The allocation of resources by item (that is, within programs and activities) in the 2008 Budget has been guided by where they can be used most effectively.

Table 28: General Goods & Services: By Item 2006 – 2008 (Kina Millions)

	2006	2007	2008	Change
	Actual	Estimate	Projection	
Operational Materials & Supplies*	360.0	377.8	437.9	+60.1
Utilities	111.9	102.4	114.5	+12.1
Rental of Property	108.2	97.5	112.2	+14.7
Grants to Individuals & NPOs	73.9	159.1	73.0	-86.1
Transport and Fuel	33.9	42.6	40.4	-2.2
Travel and Subsistence	35.0	40.9	38.7	-2.2
Routine Maintenance	24.2	25.6	42.3	+16.7
Purchase of Vehicles	17.0	15.7	13.7	-2.0
Membership Fees/Contributions	11.8	9.7	9.5	-0.2
Other**	10.7	48.1	197.1	+149.0
Total	786.6	919.4	1079.3	+159.9

Source: Department of Treasury

* Includes Other Operational Expenses.

** Other includes Office Furniture and Equipment, Training, Administrative Consultancy Fees.

The net increase (K159.9 million) in general goods and services in 2008 reflects increased funding to various expenditure programs.

The allocation for operational materials and supplies in 2008 has risen by K60.1 million or by 15.9 per cent to K437.9 million. This allocation reflects increased funding provided to various Government agencies such as: the Electoral Commission (K45.3 million) to update the common roll and conduct the Local Level Government election; and to the Department of Health (K15 million) to purchase medical supplies and equipment.

An additional K12.1 million has been allocated to utilities in 2008, to ensure that funding needs are better provided for, thus reducing the further accumulation of arrears, with attendant risks to the supply of essential services. This increased funding includes K4.2 million for Hospital Management Services utilities.

It has been recognized that various Government agencies have incurred utility arrears due to higher cost factors as well as administrative weakness in controlling consumption of the utility services. In terms of control, it is appropriate that all Government departments and agencies should ensure that appropriate corrective measures are adopted to ensure that spending is consistent with budgetary allocations.

The allocation for rental of property in 2008 has risen by K14.7 million or by 15.1 per cent to K112.2 million in order to cater for increased office space required for the new government agencies and for the vice ministries.

The routine maintenance allocation has been increased by K16.7 million in 2008 to ensure that adequate maintenance is carried out on state-owned properties used for operational purposes.

The other expenditure category has risen by a very large K149 million in 2008. The larger item is additional funding of K21.4 million to conduct the ACP-EU meeting, re-open the Kundu Sydney Consulate office and support the new Trade functions by the Department of Foreign Affairs and Trade. Furthermore, additional funding is provided for various programs such as the Tokyo Office purchased by the Department of Foreign Affairs and Trade (K15 million), K10 million for security and logistics for the conduct of LLG elections, K6 million for new gaming monitoring system for the National Gaming Control Board, and K5 million for the Commission of Inquiry into the Department of Finance.

2.4.2.5 Goods and Services: Provincial Governments

The Total Goods and Services allocation for Provincial Governments (excluding Bougainville) is K126.8 million in 2008, which is K6.1 million (or 5.1 per cent) higher than the amount provided in the 2007 Budget.

The higher allocation to Provincial Governments is to support the important role they play in the delivery of essential services at the rural sector and takes into consideration the population growth rate and the projected rate of inflation. It also reflects a rebalancing of Provincial grants from personal emoluments to goods and services.

Unconditional Grants to Provincial Governments are expected to be K15.5 million in 2008, an increase of K1.3 million from the amount provided in 2007.

Conditional Grants to Provincial Governments are expected to be K69.2 million in 2008, an increase of K2.5 million from the amount provided in 2007. The Village Court function grant which was introduced in 2007 has continued to be funded in 2008 to recognize the important services provided by the Village Courts.

In addition, Grants for Local Level Government have risen from K39.7 million in 2007 to K42 million in 2008, an increase of K2.3 million. This will assist the capacity of Local Level Governments to implement the National Government's policy of providing essential services to people throughout the nation.

Allocations to individual provinces are based on the recommendations of the National Economic and Fiscal Commission (NEFC) and are aimed at, over time, allocating goods and services funding to Provinces on the basis of the cost of services in a given Province. While still consistent with the Organic Law, this process aims to shift allocation decisions away from the unsustainable formula-based approach of earlier years to a process where, over time, grants are provided to meet actual costs (taking into account the total fiscal resources available to the Province).

Table 29: Provincial Goods & Services Grants 2006–2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Unconditional Grants	21.3	14.2	15.5	+1.3
<i>Administration/Block</i>	21.3	14.2	15.5	+1.3
Conditional Grants	58.2	66.7	69.2	+2.5
<i>Health Function</i>	11.5	13.4	14.5	+1.1
<i>Education Function</i>	20.6	21.6	21.7	+0.1
<i>Transport Maintenance</i>	14.4	15.3	16.7	+1.4
<i>Village Court Fctn Grant</i>	0.0	2.2	2.2	0.0
<i>Derivation</i>	11.7	14.2	14.1	-0.1
Other Grants for LLGs	23.1	39.7	42.0	+2.3
<i>Town & Urban Services</i>	6.6	3.0	11.1	+8.1
<i>Rural LLG</i>	16.5	36.7	30.9	-5.8
Total	102.6	120.6	126.7	+6.1

Source: Department of Treasury, NEFC.

The Provinces are provided with additional funding of K13.8 million in 2008, which is allocated in the Department of Finance and Treasury – Miscellaneous, for PBSS increments for provincial officers.

2.4.2.6 Transfers to Autonomous Bougainville Government

In June 2005, the Autonomous Bougainville Government (ABG) was formed. Among other things, the relevant Organic law provides for new financial arrangements to be provided to Bougainville.

A total of K54 million in direct grants are being provided to the ABG in the 2008 Recurrent Budget.

The Organic law requires the National Government to pay a recurrent grant to Bougainville, covering the cost of the functions it has assumed. This grant is to cover both personal emoluments and goods and services. The Recurrent Grant to Bougainville in 2008 is K51.5 million, up K2.9 million over the amount provided in 2007. This increase reflects additional funding of K2 million to cater for increase in teachers' salaries.

The allocation for goods and services was determined with reference to the NEFC's nationwide study on the costs of providing essential services in each Province, taking into account the ABG's estimated internal revenue.

The Organic Law also provides for a separate grant for the policing function in Bougainville. The Police Grant to Bougainville for goods and services is K2.2 million in 2008, reflecting a continued commitment to assist the ABG in the process of managing and administering the policing function in Bougainville.

Table 30: Transfers to Bougainville 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Police Grant ¹	2.0	2.1	2.2	0.1
Recurrent Grant ²	44.5	48.6	51.5	2.9
Conditional Grants	0.0	0.2	0.3	0.1
Total Recurrent Grant	46.5	50.9	54.0	+3.1

Source: Department of Treasury

2.4.2.7 Transfers to Statutory Authorities

The Statutory Authorities' funding will be increased in 2008 by K5.2 million to K226.8 million compared with the 2007 Budget. The increase in funding reflects a moderate adjustment for higher costs.

The Government is also committed to providing funding to the tertiary institutions to provide quality education and so increased funding has been provided to the University of Papua New Guinea (K1.7 million) for Port Moresby Nursing School and higher allowances for medical lecturers, University of Technology (K0.9 million), and University of Vudal (K1.1 million) for extra staff.

The National Broadcasting Commission is provided additional funding of K1.1 million in 2008 to cover utilities and fuel costs.

Table 31: Transfers to Statutory Authorities 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Tertiary Institutions	81.4	79.8	84.4	+4.6
UPNG	30.9	30.4	32.1	+1.7
University of Technology	29.9	29.0	29.9	+0.9
University of Goroka	10.4	11.1	11.6	+0.5
University of Vudal	6.9	5.8	6.8	+1.0
Legal Training Institute	0.8	1.0	1.3	+0.3
PNG Maritime College	2.5	2.5	2.7	+0.2
PNG Forestry Authority	23.9	24.2	24.5	+0.3
Civil Aviation Authority	17.3	15.2	12.2	-3.0
National Broadcasting Commission	12.5	12.7	13.8	+1.1
Ombudsman Commission	9.4	11.0	11.5	+0.5
Office of Auditor-General	8.9	11.0	11.2	+0.2
Tourism Promotion Authority	8.3	8.1	9.0	+0.9
National AIDS Council	4.1	5.4	5.5	+0.1
National Training Council	0.9	2.2	2.2	0.0
PNG Sports Commission	2.6	4.1	2.8	-1.3
Other *	65.0	47.9	49.7	+1.8
Total Transfers to S.A.s	234.3	221.6	226.8	+5.2

Source: Department of Treasury

Comprises NRI, NEFC, National Narcotics Bureau, Institute of Medical Research, National Youth Commission, IPA, SBDC, NISIT, ICDC, National Museum Authority, National Housing Commission, National Cultural Commission, CCI, FPDA, NARI, NAQIA, NRA, ICCG, CLRC

The Government's policy is for Statutory Authorities to become self-funding over time, allowing the Government to focus resources on core functions and MTDS priorities. However, progress in implementing the reforms in this area proposed by the *Public Expenditure Rationalization and Review* (PERR) program has been slow.

¹ Includes both personnel emoluments (staffing grants, teachers salaries) and goods and services.

However, the National Gaming Control Board has been the first institution to be self-funding and thus, will not be provided any budgetary funding but retain 5 per cent of the total gaming tax revenues to fund its operations. This arrangement has been approved through the new *Gaming Control Act 2007*.

2.4.2.8 Interest and Other Fees

Total interest and other fees payments are projected to be K373.5 million in 2008, an increase of K0.6 million from the revised estimate for 2007. The total payment is comprised of K275.3 million in domestic interest and fees outlays and K98.2 million in external interest and fees outlays.

Table 32: Interest and Other Fees 2006 – 2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Domestic Interest Outlays	187.1	252.9	275.3	+22.4
<i>Treasury Bills</i>	42.5	38.1	52.8	+14.7
<i>Inscribed Stock*</i>	142.1	210.5	218.6	+8.1
<i>Other Domestic Debts</i>	2.5	4.3	3.9	-0.4
<i>Agency Fees</i>	0.0	0.0	0.0	0.0
External Interest Outlays	119.9	119.9	98.2	-21.7
<i>Interest</i>	115.9	107.9	86.2	-21.7
<i>Other Fees</i>	4.0	12.0	12.0	0.0
Total Interest and Other Fees	307.0	372.9	373.5	+0.6

Source: Department of Treasury

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

Domestic interest payments are forecast to rise by K22.4 million in 2008 to K275.3 million. The increased payments reflect a moderate increase in Treasury Bill yields, increased interest expenses on Inscribed Stocks and the net replacement of external debt with domestic debt.

External interest payments and other fees are projected to be K98.2 million in 2008, K21.7 million lower than the revised estimate for 2007, reflecting a moderate rise in the value of the Kina against major debt currencies.

2.4.3 Development Expenditure

The Development Budget for 2008 is K1,887.1 million, which is K168.7 million (or 9.8 per cent) higher than the revised estimate for 2007. This reflects increased funding from the Government and donor agencies, especially AusAID. The Government funding allocation in 2008 has risen by K58.3 million to K763.4 million, while the donor funding is estimated to rise by K110.3 million to K1,123.7 million.

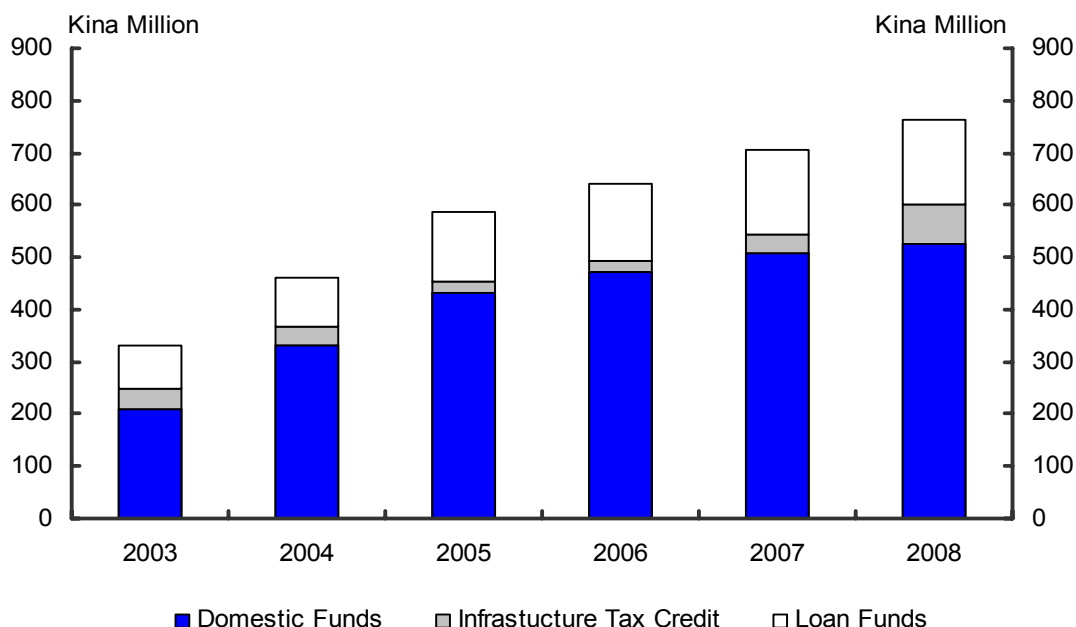
Table 33: Development Expenditure: By Source 2006–2008 (Kina Millions)

	2006 Actual	2007 Estimate	2008 Projection	Change
Government	639.5	705.1	763.4	+58.3
<i>Domestic Funding</i>	471.2	509.1	526.7	+17.6
<i>Infrastructure Tax Credit</i>	23.3	33.0	73.7	+40.7
Loans	145.0	163.0	163.0	0.0
<i>Concessional</i>	145.0	163.0	163.0	0.0
<i>Commercial</i>	0.0	0.0	0.0	0.0
Donor	914.6	1,013.4	1,123.7	+110.3
<i>Project Grants</i>	914.6	1,013.4	1,123.7	+110.3
Total Development Expenditure	1554.1	1718.4	1887.1	+168.7

Source: Department of Treasury

The Government's total commitment – domestic funding, loans drawn down and infrastructure tax credit – to the Development Budget is K763.4 million in 2008, up K58.3 million from the revised K705.1 million in 2007.

The significant increase in Government funding of the ongoing Development Budget in 2008 reflects the Government's commitment to increasing expenditure on MTDS priorities and meeting fixed commitments.

Figure 17: Government Contribution to Development Budget (Kina Millions)

Source: Department of Treasury

2.4.4 Allocation of additional mineral revenue

2.4.4.1 Approach taken in 2008 Budget

The Budget Strategy Paper (BSP) for the 2008 Budget outlined an approach approved by NEC for the special circumstances of 2008, with:

- mineral revenue being received at an unusually high level;

- funds already set aside in previous years for rehabilitating public infrastructure;
- capacity shortages constraining the rate at which those funds could be spent; and
- major projects taking shape for commercialization of PNG's gas resources.

Since then, a proposed new Medium Term Fiscal Strategy has been prepared by the Department of Treasury. It adds to the BSP approach:

- a suggested rule for dividing mineral revenue into a normal component used for funding ongoing spending, and an additional component for special uses;
- suggested principles for allocating additional mineral revenue among alternative uses, preferably public investment and debt repayment; and
- a suggested guideline that 60 per cent of additional mineral revenue should be used for public investment and 40 per cent for debt repayment.

In formulating the 2008 Budget, the Government took this into account, and also gave weight to:

- the many pressing needs for improvement of infrastructure and services at district level;
- a number of infrastructure projects already identified, and the rest of the program of National Infrastructure Development described in the Prime Minister's State of the Nation Address to Parliament on 18 September 2007;
- a continuing commitment to commercialization of PNG's gas resources;
- a range of proposals for Additional Priority Expenditures, some to take place in 2008 and some over longer time-frames;
- an intention to keep reducing the Government's superannuation liability for public servants, as was done in the 2007 Supplementary Budget; and
- the need for a safety margin of debt repayment, in case mineral revenue falls short of the high level forecast.

2.4.4.2 Allocation in 2008 Budget

The 2008 Budget allocates K1,676 million of additional mineral revenue in the following manner :

- | | |
|---|--------------|
| • District Service Improvement Programs | K534 million |
| • State equity in gas project/s | K100 million |
| • Konebada Petroleum Park infrastructure | K 50 million |
| • National Infrastructure Development Program | K196 million |
| • Reduction of superannuation liability | K150 million |
| • Safety margin/debt repayment | K200 million |
| • Additional priority expenditures | K446 million |

2.4.4.3 District Service Improvement Programs

In order to ensure that the benefits of the commodity boom are spread throughout the country, every district will be provided with a share of funds for improving service and infrastructure. This will be done by supplementing the existing District Service Improvement Programs (DSIPs) for health, water supply, law and justice, and education, and creating new ones for transport and agriculture.

The 2008 Budget provides each district with K1 million for each of the six DSIPs, at a cost of K534 million. This is additional to the funding of K4 million for each district provided in 2007 Supplementary Budget.

This program will absorb the existing District Transport Infrastructure Program, and will replace the existing Least Developed District Grants and District Support Grants.

The Government recognizes the challenges involved in using greatly increased DSIP funds effectively, and intends that district administrators will be held accountable for how these funds are used.

The Government also recognizes the need to spread the use of these funds through time, for two reasons — so that wise spending plans can be developed and capacity developed for service improvements or projects to be well implemented, and also to avoid adding to the inflationary pressures already present in the economy.

- In order to allow for multi-year expenditure plans, the funds will be placed in the District Services Improvement Program trust account, which was created for the funds provided in the 2007 Supplementary Budget.
- The DSIP funds for each district will be spent strictly in accordance with Finance Instructions.

Because the amount being provided for DSIPs is so large, the Government intends to monitor and review the program on an on-going basis.

2.4.4.4 State equity in gas commercialisation

The Government is yet to determine, in respect of LNG projects or other projects for commercialization of PNG gas resources, what amounts should be committed to State equity and how these commitments will be financed.

However, because the occasion for considering those matters is drawing close, and because the Government remains committed to supporting the commercialization of PNG gas resources, the 2008 Budget provides another K100 million for the financing of State equity in gas commercialisation projects. This will bring the total of funds set aside for this purpose to K600 million.

In addition, the Budget is providing K50 million for establishing the infrastructure of the Konebada Petroleum Park.

2.4.4.5 Reducing State debt and liabilities

The surge in mineral revenue associated with the commodity price boom provides a unique opportunity to reduce the State's debts and liabilities to more affordable and sustainable levels.

In the 2007 Supplementary Budget, the Government allocated K250 million to reduce the State's liability for the superannuation payouts of public servants, which then stood at about K1,600 million. The 2008 Budget allocates a further K150 million to reduce this liability, which will bring it down to about K1,200 million.

- As well as reducing the cost through time of the State's liability, the Government's payment of K150 million is likely to be used by Nambawan Super for increasing its investments on behalf of members, especially in private businesses in PNG.
- From the perspective of developing PNG's economy, this represents an excellent use by the Government of additional mineral revenue.

The 2008 Budget also includes providing for a "safety margin" of K200 million, intended to be reflected in repayment of public debt.

- The need for a safety margin arises from the unusual volatility of commodity prices, which makes it quite possible that there could be sudden large reductions of prices and resulting shortfalls in mineral revenue compared with the forecast for 2008. The amount of K200 million is about 8 per cent of that forecast revenue.
- The intended repayment of that amount of public debt (if mineral revenue comes in as forecast) will bring about substantial benefits. It will free additional resources from interest expenses, which can be used for the expansion of basic services, for example in health and education in every year thereafter.
- Repayment in 2008 of another K200 million of public debt would bring down the ratio of debt to GDP from about 34 per cent at the end of 2007 to about 32 per cent — helping to bring PNG closer to having what the rating agencies recognize as a sustainable level of debt.

2.4.4.6 National Infrastructure Development Program

In the Prime Minister's State of the Nation Address on 18 September 2007, he outlined the Government's program for national infrastructure development during the next four years. This program covers all sectors, with the transport sector containing the largest needs for which funding has not yet been provided.

The 2008 Budget allocates K196 million to the National Infrastructure Development Program. This sum will be held in trust until a five-year program for funding National Infrastructure Development is formulated and approved by the Government, and will then be used for its next stage.

With large amounts allocated in the last two years' Supplementary Budgets for infrastructure (see Chapter 3), and the allocations in this Budget for the National Infrastructure Development Program and the Additional Priority Expenditures (see Section 2.4.4.7), already most of the Government's infrastructure priorities for the next five years have had large amounts of funding allocated for them. This includes the Highlands Highway, the Lae Port, Central City, airports, schools, technical colleges, universities and hospitals.

2.4.4.7 Additional Priority Expenditures

The 2008 Budget provides K446.1 million for Additional Priority Expenditures. This package has been designed so that the spending will be widely distributed through the country, be helpful to economic growth and empowerment of the people, and a source of direct benefits to many people from the current surge in mineral revenue.

The Additional Investment/ Priority Expenditure package is as follows:

Outstanding Memoranda of Agreement (MOAs)	K55	million
National roads maintenance (Additional to Development Budget)	K50	million
New Government aircraft	K40	million
Rural electrification	K30	million
Tertiary institutions infrastructure	K30	million
Land reform program	K28	million
Public servant housing	K27	million
Lae roads	K25	million
ICT policy	K20	million
Central City	K20	million
Technical schools maintenance	K20	million
Misima mine closure	K20	million
Border development	K20	million
Madang Marine Park	K15	million
Cooperative societies	K10	million
South Bougainville feeder roads	K 4.1	million
Lutheran University	K 3	million
Buka – Arawa road	K 3	million
Bougainville Regional Office	K 1	million

These are one-off expenditures, and not additions to ongoing spending. If any of them continue in future years, they will be absorbed in the Development Budget under its Budget Strategy ceiling.

2.4.5 Focus on Medium Term Development Strategy (MTDS)

Consistent with its medium-term policy focus, the Government is committed to increasing the proportion of available resources being allocated to the seven priority areas identified in the Medium Term Development Strategy.

The 2007 Budget allocated 52 per cent of Budget allocations to the MTDS priority areas, with the remainder allocated to non-discretionary fixed commitments (such as interest outlays and court orders), general government administration and non-MTDS government services.

The effective implementation of the MTDS requires that the proportion of the Budget allocated to MTDS priority areas increase from 48 per cent in 2005 to 55 per cent in 2010.

A key objective of the 2008 Budget is to lift the proportion of the Budget allocated to MTDS priority areas.

- The target for 2008 is for **53 per cent** of total PNG expenditure to be allocated to MTDS priority areas.
- The target for 2008 is for **88.5 per cent** of total PNG development expenditure to be allocated to MTDS priority areas.

The 2008 Budget exceeds the total expenditure target with 55.5 per cent allocated to MTDS priorities. However, the 2008 Budget does not achieve the development expenditure target with 82.7 per cent allocated to MTDS priorities.

2.4.5.1 MTDS priority spending

The Government's commitment to MTDS priority areas is reflected in the distribution of both recurrent and development expenditure.

Table 34: Composition of MTDS priority spending: 2006-2008 (Kina Millions)

	2007	2008	2008	2008
	Budget	Recurrent	Development	Total
Primary & Preventative Health	427.5	635.7	44.0	679.7
HIV/AIDS	18.1	5.7	17.0	22.7
Law and Justice	385.3	472.7	31.0	503.7
Transport Infr. Maint. & Rehab.	165.8	285.9	338.1	623.9
Income Earning Opportunities	184.8	400.8	55.5	456.3
Basic Education	518.5	703.2	10.5	713.7
Dev. Oriented adult education	24.9	15.8	3.7	19.5
Other	456.9	154.6	131.2	285.8
Total MTDS Expenditure	2181.8	2674.5	631.0	3305.3

Source: Department of Treasury

2.4.6 Monitoring of additional spending

The additions which this Budget makes to ongoing spending, funding of district services, pre-funding of infrastructure spending and additional priority expenditures will all have stimulatory effects on the economy.

Therefore, the Government intends that spending of these funds will be governed by a prudent overall strategy for demand management. It will monitor the rates of spending from the District Service Improvement Trust, from the trust account for National Infrastructure Development, and from the trust accounts for infrastructure rehabilitation and maintenance, as well as the Additional Priority Expenditures. This monitoring will have the aims of :

- accelerating implementation of the highest priority services and infrastructure work;
- applying high quality standards to all the work; and
- ensuring that the overall rate of spending does not become excessive and cause wastage through profiteering and price inflation.

The Government will aim to ensure that the stimulatory effect of this Budget is not sudden and excessive, but sustained through the medium term. This will mean the best prospect of expanding employment in a sustainable way. In particular, continued funding of infrastructure projects will also encourage construction companies to build up their presence here, increasing employment and training opportunities for Papua New Guineans.

2.5 FINANCING

2.5.1 Overview

In 2008, the Budget is expected to be in surplus of K202.3 million, which is 1 per cent of GDP. This is consistent with the proposed new MTFs and means that the Government will reduce the total debt by K202.3 million.

The net external financing is expected to be an outflow of K297.3 million which is to be offset by an expected net domestic inflow of K77 million and the Budget surplus of K202.3 million.

2.5.2 External Financing

Total new external borrowing of K164 million is expected to be undertaken in 2008, reflecting additional drawdowns on existing concessional loans.

Repayments (amortization) of existing loans of K443.3 million will more than offset new borrowing resulting in a net external outflow of K279.3 million in 2008.

2.5.3 Domestic Financing

The net domestic funding required in 2008 to fund the outflows in external financing will be K77 million. This consists of K1,630 million in new borrowing and amortization of K1,553 million. No receipts from asset sales have been factored into financing of the 2008 Budget.

CHAPTER 3. STATUS OF SUPPLEMENTARY BUDGETS

3.1 OVERVIEW

Since the commodity boom began to boost Government revenues in 2005, there has been more than K3.8 billion provided for additional expenditures through Supplementary Budgets (in November 2005: K400 million, August 2006: K682.5 million, November 2006: K1,100 million and October 2007: K1,637 million).

Some of these were top-ups of ongoing spending, but the vast majority of the funds have been allocated for investment purposes reflecting the MTDS priorities. Table 35 provides a breakdown. The transport sector has received the largest amount, with education and health also receiving large amounts. More details of the Supplementary Budgets are provided below. The Supplementary Budget Status reported here is as at 23rd October 2007.

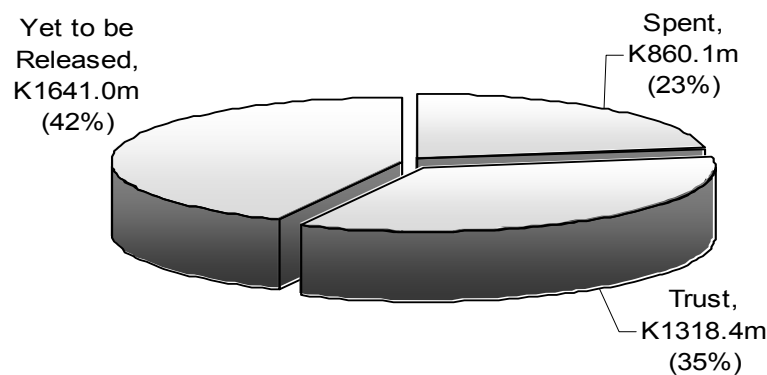
The headings of the tables presented in this chapter, are described as follows:

- Appropriated – is the total Appropriation for each sector from the various Supplementary Budget as passed.
- Share of Total Appropriated – is the share appropriated for each sector compared against the total appropriation.
- Spent – the total spending made out from the Government coffers to the various sectors as approved under the Supplementary Budget.
- Paid into Trust – is the transfer out from the Government coffers to the various sectors Trust Accounts as approved under the Supplementary Budget.
- Yet to be released – is the amount that has yet to be released from the Appropriation.

Table 35: Supplementary Budget Appropriation and Expenditure as at 23rd October 2007

	Appropriated (K'million)	Share of Total Appropriated (Per cent)	Spent (K'million)	Paid into Trust (K'million)	Yet to be Released (K'million)
Health	388	10	21	185	182
Education	453	12	34	247	172
Law and Justice	333	9	36	120	177
Transport Infrastructure	634	17	216	140	278
Income Earning Opportunities	140	4	10	75	55
Gas Equity	500	13	0	500	0
Debt and Super Liability Repayment	647	17	100	0	547
Others (Non-MTDS)	725	19	443	51	231
TOTAL	3820	100	860	1318	1642

Source: Department of Treasury and Department of Finance

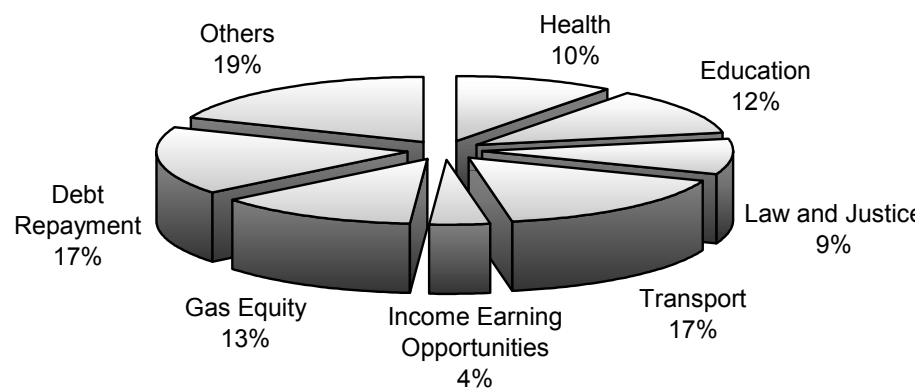
Figure 18: Summary of the Supplementary Budget Status

Source: Department of Treasury and Department of Finance

Of the additional funds allocated in these two years, as of late 2007, around 77 per cent are yet to be released or are in trust accounts awaiting expenditure. Almost all of the funds yet to be released have only recently been appropriated under the 2007 Supplementary Budget, and are expected to be placed into trust shortly.

This use of large amounts of “windfall” revenue to pre-fund public investments necessarily involves a delay in most of the funds being spent, for the following reasons;

- It takes time to develop and implement high-quality spending proposals.
- Given the large amounts involved, if they were all spent rapidly there would be wastage through inflationary effects, because of capacity constraints in both the private and public sectors.
- As well as providing the best value for money, spreading the expenditure through time encourages companies bidding for contracts to increase their capacity in anticipation of continued public investments, rather than have the boom and bust of previous commodity cycles.

Figure 19: Supplementary Budget Appropriation in Various Sectors

Source: Department of Treasury and Department of Finance

3.2 HEALTH SECTOR

The Health Sector received 10 per cent or K387.9 million in total appropriation from the Supplementary Budgets. Of this, K20.6 million has been spent, K185.3 million has been paid into Trust Accounts and K182 million is yet to be released. Details of the additional expenditure for the Health Sector as appropriated under the Supplementary Budgets are shown in Table 36 below.

Table 36: Health Sector Supplementary Budget Status

	Appropriated	Spent	Paid Into Trust	Yet to be Released	Total
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)					
MTDS Priorities	95.9	10.9	85.0	0.0	95.9
<i>Hospital Rehabilitation Plan</i>	70.0	0.0	70.0	0.0	70.0
<i>Nurse Housing</i>	15.0	0.0	15.0	0.0	15.0
<i>District Health Improvement</i>	8.9	8.9	0.0	0.0	8.9
<i>Bird Flu Preparation</i>	2.0	2.0	0.0	0.0	2.0
Total	95.9	10.9	85.0	0.0	95.9
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
Health Sector	110.0	9.7	100.3	0.0	110.0
<i>Church health workers</i>	9.7	9.7	0.0	0.0	9.7
<i>Other health</i>	100.3	0.0	100.3	0.0	100.3
Total	110.0	9.7	100.3	0.0	110.0
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)					
Additions to Spending	13.0	0.0	0.0	13.0	13.0
<i>Doctor's Back-Pay</i>	10.0	0.0	0.0	10.0	10.0
<i>Avian Flu - NAQIA Funding</i>	3.0	0.0	0.0	3.0	3.0
District Infrastructure Funding	89.0	0.0	0.0	89.0	89.0
<i>District Health Improvement Program</i>	89.0	0.0	0.0	89.0	89.0
Public Infrastructure Maintenance Funds	80.0	0.0	0.0	80.0	80.0
<i>Health</i>	80.0	0.0	0.0	80.0	80.0
Total	182.0	0.0	0.0	182.0	182.0
Grand Total	387.9	20.6	185.3	182.0	387.9

Source: Department of Treasury and Department of Finance

3.3 EDUCATION

The Education Sector received a total of 12 per cent or K452.9 million in appropriation from the Supplementary Budgets. Of this, K33.8 million was spent, K247.1 million has been paid into Trust Accounts and K172 million is yet to be released. Details of the Additional expenditure for the Education Sector as appropriated under the Supplementary Budgets are shown in Table 37.

Table 37: Education Sector Supplementary Budget Status

	Appropriated	Spent	Paid Into Trust	Yet to be Released	Total
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)					
MTDS Priorities	8.9	8.9	0.0	0.0	8.9
<i>District Education Improvement</i>	8.9	8.9	0.0	0.0	8.9
Meeting Obligations	40.0	14.9	25.1	0.0	40.0
<i>PBSS (teachers)</i>	40.0	14.9	25.1	0.0	40.0
Non-MTDS Priorities	12.0	10.0	2.0	0.0	12.0
<i>Emergency School Maintenance</i>	7.0	7.0	0.0	0.0	7.0
<i>Bana High School</i>	3.0	3.0	0.0	0.0	3.0
<i>Kubalia High School</i>	2.0	0.0	2.0	0.0	2.0
Total	60.9	33.8	27.1	0.0	60.9
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
PBSS payments (teachers)	20.0	0.0	20.0	0.0	20.0
Total	20.0	0.0	20.0	0.0	20.0
2007 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
Education Infrastructure	200.0	0.0	200.0	0.0	200.0
<i>Higher education</i>	50.0	0.0	50.0	0.0	50.0
<i>Other education</i>	150.0	0.0	150.0	0.0	150.0
Total	200.0	0.0	200.0	0.0	200.0
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)					
Additions to Spending	3.0	0.0	0.0	3.0	3.0
<i>Marienberg Community College</i>	3.0	0.0	0.0	3.0	3.0
District Infrastructure Funding	89.0	0.0	0.0	89.0	89.0
<i>District Education Improvement Program</i>	89.0	0.0	0.0	89.0	89.0
Public Infrastructure Maintenance Funds	80.0	0.0	0.0	80.0	80.0
<i>Education</i>	80.0	0.0	0.0	80.0	80.0
Total	172.0	0.0	0.0	172.0	172.0
Grand Total	452.9	33.8	247.1	172.0	452.9

Source: Department of Treasury and Department of Finance

3.4 LAW AND JUSTICE SECTOR

The Law and Justice Sector received a total of 8.7 per cent or K333.3 million in appropriation from the Supplementary Budgets. Of this, K36.3 million was spent, K120 million has been paid into Trust Accounts and K177 million is yet to be released. Details of the Additional Expenditure for this Sector as appropriated under the Supplementary Budgets are shown in Table 38.

Table 38: Law and Justice Sector Supplementary Budget Status

	Appropriated	Spent	Paid Into Trust	Yet to be Released	Total
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)					
MTDS Priorities	58.5	33.5	25.0	0.0	58.5
<i>Police Housing</i>	25.0	0.0	25.0	0.0	25.0
<i>Judiciary - Court House Upgrade</i>	9.0	9.0	0.0	0.0	9.0
<i>Police Pay</i>	8.0	8.0	0.0	0.0	8.0
<i>Southern Highlands Security Situation</i>	8.0	8.0	0.0	0.0	8.0
<i>Improved conditions for State lawyers</i>	3.0	3.0	0.0	0.0	3.0
<i>Land mediation for resource projects</i>	2.5	2.5	0.0	0.0	2.5
<i>Juvenile Detention Facilities</i>	2.0	2.0	0.0	0.0	2.0
<i>Border Facilities Upgrade</i>	1.0	1.0	0.0	0.0	1.0
Meeting Obligations	20.0	0.0	20.0	0.0	20.0
<i>PBSS (police)</i>	20.0	0.0	20.0	0.0	20.0
Non-MTDS	2.8	2.8	0.0	0.0	2.8
<i>Leadership Tribunals</i>	2.8	2.8	0.0	0.0	2.8
Total	81.3	36.3	45.0	0.0	81.3
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
Law and Justice Sector	25.0	0.0	25.0	0.0	25.0
<i>Police Housing</i>	25.0	0.0	25.0	0.0	25.0
Total	25.0	0.0	25.0	0.0	25.0
2007 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
Law and Justice infrastructure	50.0	0.0	50.0	0.0	50.0
Total	50.0	0.0	50.0	0.0	50.0
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)					
Additions to Spending	8.00	0.0	0.0	8.00	8.00
<i>Outstanding Legal Fees</i>	8.0	0.0	0.0	8.0	8.0
District Infrastructure Funding	89.0	0.0	0.0	89.0	89.0
<i>District Law and Justice Program</i>	89.0	0.0	0.0	89.0	89.0
Public Infrastructure Maintenance Funds	80.0	0.0	0.0	80.0	80.0
<i>Law and Justice</i>	80.0	0.0	0.0	80.0	80.0
Total	177.0	0.0	0.0	177.0	177.0
Grand Total	333.3	36.3	120.0	177.0	333.3

Source: Department of Treasury and Department of Finance

3.5 TRANSPORT SECTOR

The Transport Sector received a total of 16.6 per cent or K633.5 million in appropriation from the Supplementary Budgets. Of this, K215.5 million was spent, K140 million has been paid into Trust Accounts and K278 million is yet to be released. Details of the Additional

Expenditure for this Sector as appropriated under the Supplementary Budgets are shown in Table 39 below.

Table 39: Transport Sector Supplementary Budget Status

	Appropriated	Spent	Paid Into Trust	Yet to be Released	Total
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)					
MTDS Priorities	235.5	215.5	20.0	0.0	235.5
<i>Highlands Highway</i>	70.0	70.0	0.0	0.0	70.0
<i>District Transport Inf. Project</i>	44.5	44.5	0.0	0.0	44.5
<i>Airport Rehabilitation</i>	30.0	10.0	20.0	0.0	30.0
<i>Gurney Airport</i>	2.0	2.0	0.0	0.0	2.0
<i>Road & Bridge Maintenance</i>	22.0	22.0	0.0	0.0	22.0
<i>Commodity Roads Improvement</i>	20.0	20.0	0.0	0.0	20.0
<i>ADB Navigational Aids</i>	7.4	7.4	0.0	0.0	7.4
<i>Gazelle Restoration</i>	9.6	9.6	0.0	0.0	9.6
<i>Gobe-Semberigi</i>	10.0	10.0	0.0	0.0	10.0
<i>Buka Ring Road</i>	10.0	10.0	0.0	0.0	10.0
<i>Napa Napa Road Link</i>	5.0	5.0	0.0	0.0	5.0
<i>District Vessels</i>	5.0	5.0	0.0	0.0	5.0
Total	235.5	215.5	20.0	0.0	235.5
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
Transport Sector	76.0	0.0	76.0	0.0	76.0
<i>Highlands Highway</i>	35.0	0.0	35.0	0.0	35.0
<i>National Roads</i>	21.0	0.0	21.0	0.0	21.0
<i>Provincial Roads</i>	20.0	0.0	20.0	0.0	20.0
Total	76.0	0.0	76.0	0.0	76.0
2007 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
Transport Sector Infrastructure	44.0	0.0	44.0	0.0	44.0
<i>District Roads</i>	20.0	0.0	20.0	0.0	20.0
<i>Ports and jetties</i>	14.0	0.0	14.0	0.0	14.0
<i>Wewak airport</i>	10.0	0.0	10.0	0.0	10.0
Total	44.0	0.0	44.0	0.0	44.0
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)					
Approved Programs	21.00	0.0	0.0	21.00	21.00
CAA	21.0	0.0	0.0	21.0	21.0
Major Improvements in Infrastructure	257.0	0.0	0.0	257.0	257.0
<i>Lae Roads</i>	25.0	0.0	0.0	25.0	25.0
<i>Lae Port</i>	145.0	0.0	0.0	145.0	145.0
<i>Wewak Wharf</i>	37.0	0.0	0.0	37.0	37.0
<i>Central City</i>	30.0	0.0	0.0	30.0	30.0
<i>Wewak Town Roads</i>	10.0	0.0	0.0	10.0	10.0
<i>Port Moresby Wharf</i>	10.0	0.0	0.0	10.0	10.0
Total	278.0	0.0	0.0	278.0	278.0
Grand Total	633.5	215.5	140.0	278.0	633.5

Source: Department of Treasury and Department of Finance

3.6 INCOME EARNING OPPORTUNITY

The Income Earning Opportunity Sector received a total of 3.7 per cent or K140 million in appropriation from the Supplementary Budgets. Of this, K10 million was spent, K75 million has been paid into Trust Accounts and K55 million is yet to be released. Details of the Additional Expenditure for this Sector as appropriated under the Supplementary Budgets are shown in Table 40 below.

Table 40: Income Earning Opportunity Sector Supplementary Budget Status

	Appropriated	Spent	Paid Into Trust	Yet to be Released	Total
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)					
MTDS Priorities	25.0	10.0	15.0	0.0	25.0
<i>Gas Project Business Develop.</i>	<i>15.0</i>	<i>0.0</i>	<i>15.0</i>	<i>0.0</i>	<i>15.0</i>
<i>Cocoa Pod Outbreak</i>	<i>10.0</i>	<i>10.0</i>	<i>0.0</i>	<i>0.0</i>	<i>10.0</i>
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
Agriculture Projects	35.0	0.0	35.0	0.0	35.0
Total	35.0	0.0	35.0	0.0	35.0
2007 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
District markets	20.0	0.0	20.0	0.0	20.0
Agriculture Projects	5.0	0.0	5.0	0.0	5.0
Total	25.0	0.0	25.0	0.0	25.0
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)					
Approved Programs	40.0	0.0	0.0	40.0	40.0
<i>NADP</i>	<i>40.0</i>	<i>0.0</i>	<i>0.0</i>	<i>40.0</i>	<i>40.0</i>
Additions to Spending	15.0	0.0	0.0	15.0	15.0
<i>Cocoa Pod Borer</i>	<i>12.0</i>	<i>0.0</i>	<i>0.0</i>	<i>12.0</i>	<i>12.0</i>
<i>Natl Forest Auth. - Impact Projects</i>	<i>3.0</i>	<i>0.0</i>	<i>0.0</i>	<i>3.0</i>	<i>3.0</i>
Total	55.0	0.0	0.0	55.0	55.0
Grand Total	140.0	10.0	75.0	55.0	140.0

Source: Department of Treasury and Department of Finance

3.7 GAS EQUITY

The Government's contribution to Gas Equity totalled K500 million. This is 13 per cent of the total Supplementary Appropriation. These funds are now held in Trust Accounts with the Central Bank.

Table 41: Gas Equity Funding

	Appropriated	Spent	Paid Into Trust	Yet to be Released	Total
2005 SUPPLEMENTARY BUDGET					
<i>Gas Pipeline Equity</i>	<i>400.0</i>	<i>0.0</i>	<i>400.0</i>	<i>0.0</i>	<i>400.0</i>
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
<i>Gas Project Equity</i>	<i>100.0</i>	<i>0.0</i>	<i>100.0</i>	<i>0.0</i>	<i>100.0</i>
Grand Total	500.0	0.0	500.0	0.0	500.0

Source: Department of Treasury and Department of Finance

3.8 DEBT REPAYMENT

A total of 17 per cent or K647 million under the Supplementary Budget has been appropriated for Debt and Superannuation Liability Repayment. Of this amount, K100 million has been paid in 2006 and K547 million is to be paid before the end of the fiscal year 2007.

Table 42: Debt Repayment Status

	Appropriated	Spent	Paid Into Trust	Yet to be Released	Total
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
<i>Debt repayment</i>	100.0	100.0	0.0	0.0	100.0
Total	100.0	100.0	0.0	0.0	100.0
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)					
<i>Nambawan Super Limited</i>	250.0	0.0	0.0	250.0	250.0
<i>Debt repayment</i>	297.0	0.0	0.0	297.0	297.0
Total	547.0	0.0	0.0	547.0	547.0
Grand Total	647.0	100.0	0.0	547.0	647.0

Source: Department of Treasury and Department of Finance

3.9 OTHERS

Under Others, a total of 19 per cent or K724.9 million has been appropriated for various outstanding Government one-off obligations, economic impact recurrent expenditure, maintenance, and other expenditure that supports the MTDS Priorities. Details of these transactions are shown in Table 43.

Table 43: Other Supplementary Budget Status.

	Appropriated	Spent	Paid Into Trust	Yet to be Released	Total
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)					
MTDS Support	22.0	22.0	0.0	0.0	22.0
<i>Economic Projects Power Upgrade</i>	8.0	8.0			8.0
<i>Provincial Economic Impact</i>	7.0	7.0			7.0
<i>Rural Electrification</i>	4.0	4.0			4.0
<i>Economic Projects Water Upgrade</i>	3.0	3.0			3.0
Meeting Obligations	112.8	112.8	0.00	0.0	112.8
<i>Outstanding MOA projects</i>	36.0	36.0			36.0
<i>Sec Advance</i>	20.0	20.0			20.0
<i>Additional SSGs</i>	19.0	19.0			19.0
<i>Outstanding DDP</i>	13.9	13.9			13.9
<i>Outstanding BRF</i>	10.0	10.0			10.0
<i>Outstanding Court Orders</i>	5.0	5.0			5.0
<i>O/S SDDG</i>	4.9	4.9			4.9
<i>O/S DSG</i>	4.0	4.0			4.0
Non-MTDS	49.08	48.58	0.00	0.00	49.08
<i>District Treasury Rollout</i>	22.0	22.0			22.0
<i>Politicians Allowances</i>	6.0	6.0			6.0

<i>Manam Resettlement Requirements</i>	4.0	4.00			4.0
<i>Members Retirement Benefits</i>	3.7	3.7			3.7
<i>Col into Finance</i>	3.7	3.7			3.7
<i>Pacific Balanced Fund investigation</i>	2.5	2.0			2.5
<i>National Urbanisation Policy</i>	2.45	2.45			2.45
<i>Intra Govt Info system</i>	1.5	1.5			1.5
<i>Disabled Rehab Support</i>	1.1	1.1			1.1
<i>Events Council Overrun</i>	0.69	0.69			0.69
<i>Moruata House - Lift Modernisation</i>	0.64	0.64			0.64
<i>Moitaka Wildlife Feasibility Study</i>	0.5	0.5			0.5
<i>PAC Additional Funding</i>	0.3	0.3			0.3
Total	183.88	183.38	0.0	0.0	183.88
2006 SUPPLEMENTARY BUDGET (NOVEMBER 2006)					
Water scoping Studies	9.0	9.0			9.0
Equity into SOEs	130.0	130.0			130.0
Public service sign on	25.0	25.0			25.0
Volcano victims	20.0		20.0		20.0
Total	184.0	164.0	20.0	0.0	184.0
2007 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)					
District Finance Rollout	30.0	30.0		0.0	30.0
NBC infrastructure	21.0		21.	0.0	21.0
Bougainville infrastructure	20.0	20.0		0.	20.0
Maintenance of Parliament	10.0		10.0	0.0	10.0
Phasing of election	30.0	30.0		0.0	30.0
Parliament one offs	20.0	16.0		4.0	20.0
Total	131.0	96.0	31.0	4.0	131.0
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)					
Approved Programs	17.36	0.0	0.0	17.36	17.36
<i>Provincial Disaster Fund</i>	7.0			7.0	7.0
<i>Maritime Boundary Project</i>	5.0			5.0	5.0
<i>Technical Rapid Response</i>	3.0			3.0	3.0
<i>Greenhouse Office</i>	1.0			1.0	1.0
<i>Office of Rural Development</i>	0.75			0.8	0.8
<i>Community Development</i>	0.61			0.6	0.6
Additions to Spending	79.64	0.0	0.0	79.64	79.64
<i>2007 National Election - cost overruns</i>	15.0			15.0	15.0
<i>Secretary's Advance</i>	20.0			20.0	20.0
<i>SSGs</i>	15.0			15.0	15.0
<i>Defence Force - New Uniforms</i>	8.0			8.0	8.0
<i>Court Orders</i>	8.54			8.5	8.5
<i>Murik Lakes Resettlement</i>	2.1			2.1	2.1

<i>Carteret Island Resettlement</i>	2.0			2.0	2.0
<i>Mirigini and Morata Haus Refurbishment</i>	4.0			4.0	4.0
<i>FMIP Funding Gap</i>	2.0			2.0	2.0
<i>Land Development Committee</i>	3.0			3.0	3.0
District Infrastructure Funding	89.0	0.0	0.0	89.0	89.0
<i>District Water Supply Program</i>	89.0			89.0	89.0
Major Improvements in Infrastructure	40.0	0.0	0.0	40.0	40.0
<i>Institutional Housing - pilot projects</i>	10.0			10.0	10.0
<i>Housing and Urbanisation - pilot projects</i>	30.0			30.0	30.0
Total	226.0	0.0	0.0	226.0	226.0
Grand Total	724.9	443.38	51.0	230.0	724.9

Source: Department of Treasury and Department of Finance

3.10 TRUST ACCOUNTS TRANSACTIONS

The following table shows transactions for each Trust Account. The opening balance as at January 1 2007 totaled K968.4 million. During the fiscal year 2007, a total of K350 million as appropriated under the Additional Priority Expenditure in November 2006, has been transferred into these various Trust Accounts. Transactions out of these Trust Accounts totaled K46.6 million. The closing balance is estimated to be K1,272 million as at 23rd October 2007.

Table 44: Trust Accounts Transaction to 23rd October 2007

	Total Appropriation	Opening Balance 1 Jan 07	Credits	Debits	Closing Balance 23 Oct 07
Hospital & Healthcare Centre Rehab	250.3	170.3	0.0	12.4	157.9
Nurses Housing	15.0	15.0	0.0	0.0	15.0
Police Housing	50.0	50.0	0.0	1.5	48.5
Airports Infrastructure	30.0	20.0	10.0	1.7	28.4
Gas Project Dev & Com	15.0	15.0	0.0	0.0	15.0
Teachers PBSS	45.1	45.1	0.0	0.0	45.2
Police PBSS	20.0	20.0	0.0	17.0	3.0
Kubalia School	2.0	2.0	0.0	0.0	2.0
Highlands Highway	35.0	35.0	0.0	0.0	35.0
Transport Sector Infrastructure	332.0	41.0	34.0	5.2	69.8
Gas Equity	100.0	500.0	0.0	0.0	500.0
Agriculture Projects	40.0	35.0	5.0	8.3	31.7
Volcano Victims	20.0	20.0	0.0	0.6	19.4
Education Infrastructure	230.0	0.0	150.0	0.0	150.0
Higher Education Infrastructure	50.0	0.0	50.0	0.0	50.0
Law and Justice Sector Infrastructure	130.0	0.0	50.0	0.0	50.0
NBC	21.0	0.0	21.0	0.0	21.0
District Markets	20.0	0.0	20.0	0.0	20.0
National Parliament Infrastructure	10.0	0.0	10.0	0.0	10.0
Housing and Urbanisation Pilot Project	40.0	0.0	0.0	0.0	0.0
District Support Improvement	356.0	0.0	0.0	0.0	0.0
Total	1811.4	968.4	350.0	46.6	1272.0

Source: Department of Treasury and Department of Finance

CHAPTER 4. 2008 BUDGET REVENUE MEASURES

4.1 OVERVIEW

The Government continues to draw from the benefits of high commodity prices and an improved domestic macroeconomic environment. The 2008 Budget will not introduce any new taxes or tax increases.

The 2008 Budget will instead further reduce income tax. It will also provide assistance to businesses by removing several stamp duties that are considered as impediments to business. These reforms are designed to encourage more investment to facilitate economic growth.

In implementing these policy initiatives, the Government is mindful that the current favorable international conditions being experienced are not expected to be sustained over the medium term. The initiatives are sustainable, based on projected growth in the non-mineral revenue base.

In 2007 the excise rate for gasoline-oil fuel (known as “Zoom”) was reduced on a trial basis. This trial will be extended for another year to allow sufficient data collection to enable the Government to determine the future of this policy.

4.2 INCOME TAX REFORM

In the 2006 Budget the Government announced significant personal income tax reductions to be phased in during 2006 and 2007. Given the backdrop of ongoing revenue that is continuing to grow, the Government has decided to provide further income tax relief. In the 2008 Budget, the Government will further reduce personal income tax to encourage participation in the growth of the economy.

The Government considers the tax relief that can now be provided should be directed primarily at lower income earners. Accordingly, the tax-free threshold will be increased from K6,600 to K7,000 commencing 1 January 2008.

In addition, the Government considers the current initial marginal rate of personal income tax of 25 per cent is relatively high compared to many other countries. The high initial marginal tax rate in Papua New Guinea represents a significant disincentive for low income earners to work longer hours or to seek higher paid work with more responsibility. The Government will therefore reduce the initial marginal tax rate from 25 per cent to 22 per cent from 1 January 2008. The increase in the tax-free threshold combined with the reduction in the lowest marginal tax rate provides a tax cut of K430 per year to individual tax payers earning K18,000 or above per annum.

Table 45 compares the current and new personal income tax rates and thresholds while Table 1.5 of the Revenue Tables (Appendix 1) shows the percentage reductions in the tax burden for taxpayers on different incomes and the larger relative reduction in tax paid for lower income earners.

Table 45: Current and new personal income tax rates & thresholds

Current PNG tax rates/thresholds		New 2008 PNG rates/thresholds	
Threshold	Rates	Threshold	Rates
0	0%	0	0%
6,600	25%	7,000	22%
18,000	30%	18,000	30%
33,000	35%	33,000	35%
70,000	40%	70,000	40%
250,000	42%	250,000	42%

Source: Department of Treasury

4.3 STAMP DUTY REFORM

Stamp duties are taxes that are levied on transactions. The transactions subject to stamp duty include loans, insurance contracts, bank withdrawals, setting up companies, transfer of property, leasing of land or goods and the sale of shares. The imposition of stamp duties can significantly increase the cost of doing business. Some are low value 'nuisance' taxes that raise small amounts of revenue and the removal of these taxes will save compliance costs for business and reduce tax administration costs for Government.

Consistent with the Government's commitment to removing impediments to doing business and investment, the Government will abolish a number of stamp duties as part of the 2008 Budget.

The following stamp duties will be abolished from 1 January 2008:

- (i) Agreement or Contracts for Loan;
- (ii) Loan Securities, Mortgages and Foreign Securities;
- (iii) Hire and Credit Purchase Agreements;
- (iv) Credit Arrangement;
- (v) Bills of lading; and
- (IV) Certificates of incorporation.

Stamp duty on insurance contracts and debits tax will also be abolished in 2008. However, because of the time required to adjust computing and billing systems in banks and insurance companies, it is not feasible to abolish these stamp duties from 1 January 2008. Accordingly, these two stamp duties will be abolished from 1 April 2008.

The abolition of these taxes will also have direct benefits to individuals who engage in transactions subject to these taxes.

4.4 2007 TARIFF REVIEW

In the 2007 Budget, the Government announced a review of its seven-year Tariff Reduction Program (TRP), which expired at the end of 2006. The Independent Review determined that in general, the TRP has achieved its intended effect of improving economic efficiency in the private sector. The gains to all stakeholders including producers and consumers can be maximised if the structural impediments adding to business costs are effectively addressed.

The recommendations of the 2007 Review are being considered and the Government is expected to be announcing the details of a further scheduled tariff reform in 2008, for implementation in 2009 and beyond.

4.5 HIGHLANDS HIGHWAY INFRASTRUCTURE TAX CREDIT SCHEME

The Government recognizes that the Highlands Highway is a very important infrastructure asset of the State that is in a strategic location, serving over 40 per cent of the country's population. Prior to 2002, the maintenance and rehabilitation of the Highway was neglected, resulting in its deterioration which threatened the many businesses and people who depend on it to sustain their livelihoods.

In order to address the maintenance issue, the Government introduced a one year special Infrastructure Tax Credit (ITC) rate of 1.25 per cent in 2002 for the Highlands Highway. This allowed resource companies to undertake maintenance and rehabilitation work on affected sections of the Highlands Highway and claim the expenditure as a credit against their assessable income. In the 2005 Budget, the special ITC scheme was renewed for another year with the normal two year carry-forward for unused credits.

Between 2002 and 2004, up to 109 kilometres of the affected sections of the Highlands Highway were maintained and rehabilitated at a cost of K21.5 million under the ITC scheme.

Since 2005, the total ITC funding increased further to K170 million of which a significant amount was directed to maintenance and rehabilitation work on the Highlands Highway. In 2006 and 2007, over K250 million has been provided through direct budget funding for maintenance and rehabilitation of the Highlands Highway, including replacement of bridges.

The Highlands Highway ranks in the top “very high priority” national roads under the Government’s Transport Development Plan (2006-2010). This Plan is to provide safe and reliable transport services to all sections of the community in PNG through maintenance and rehabilitation of existing roads, and construction of new roads only where economically feasible.

There are however administrative and capacity issues affecting timely and proper implementation of projects, thereby causing unnecessary delays and additional costs for the State. In view of these issues and the priority already given to the Highlands Highway, the special ITC rate of 1.25 per cent for the Highlands Highway will be allowed to expire at the end of 2007. The general ITC rate of 0.75 per cent is still available and can be used by companies for maintenance of the Highlands Highway.

4.6 REFORM OF BEER EXCISE

There are currently three rates of excise based on the alcohol content of the beer - a “low strength” rate, a “standard” rate and a “high strength” rate. The lowest rate applies to beer with an alcohol content of not more than 2.5 per cent alcohol by volume. This incentive has not yet resulted in the production of this type of beer in Papua New Guinea. However, a trial of “mid strength” beer has recently commenced.

The Government supports the production of lower strength beers. However, the existing structure does not provide any incentive for the production of “mid strength” beer. Currently, such beer is taxed at the “standard” rate. To encourage the production of “mid strength” beer the Government will restructure the thresholds for the application of beer excise and introduce a new concessional rate for “mid strength” beer. This will apply to beer with an alcohol content by volume of more than 2.5 per cent but not more than 3.5 per cent. The proposed four excise rates are as shown in Table 46 below.

Table 46: Beer Excise Rates and Thresholds from 30 November 2007

Description	Excise Duty Rate
Beer not more than 2.5% alcohol	K34.52 per lal
Beer more than 2.5% and not more than 3.5% alcohol	K44.53 per lal
Beer more than 3.5% and not more than 4.5% alcohol	K50.74 per lal
Beer more than 4.5% alcohol	K58.92 per lal

Source: Department of Treasury

The new structure and rates of excise will apply from 30 November 2007.

4.7 GASOLINE OIL FUEL (“ZOOM”)

The 2007 Budget announced that a concessional excise rate of 30 toea per litre would be levied on pre-mixed gasoline oil fuel (“zoom”) for 2007. Previously, the majority gasoline component was taxed at the rate applying to gasoline (61 toea per litre). The impact of the measure was to be assessed prior to the 2008 Budget so that a decision could be made whether to make this measure permanent. Unfortunately, the reform was not able to be implemented until June 2007. Because of the delay in implementation, insufficient data is available to make an assessment of the impact of this measure. As a consequence, this measure will be extended until the end of 2008 so that an assessment can be made in time for the 2009 Budget.

4.8 TAX CONCESSIONS

As part of the efforts to encourage investment, the Government offers a number of tax concessions in the agriculture, forestry, fisheries, manufacturing, petroleum, and mining sectors.

As well as sector specific concessions, there are some tax concessions that can be claimed by all. They include:

- Research and Development Incentive, where a 150 per cent income tax deduction is allowed for expenditure on Research and Development.
- Double deduction for Staff Training Costs, which allows a double deduction against company income tax for the payment of salary and wages of registered apprentices or other employees attending full-time training at a Government training Institute or prescribed tertiary institution.
- Duty Drawback, which is a rebate paid to exporting manufacturers when they export goods equal to the amount of duty already paid on new materials.
- Export Sales Exemption, which exempts profits from export sales for the first three years and income from increases in exports for the following four years.
- Accelerated and Flexible Depreciation, which allows for capital assets to be written off at a faster rate than their effective lives.

4.8.1 Estimating the size of tax concessions

The Government has over successive budgets been estimating and reporting on the size of its tax concessions. Table 47 shows the estimated size of the tax concessions for the past five years. Details of the amounts forgone are set out in Appendix 1 Table 1.2 -1.4.

Table 47: Estimated Cost of Tax Concessions 2002 to 2006 (Kina Millions)

Year	2002	2003	2004	2005	2006
Amount	34.4	76.7	34.9	37.7	30

Source: Department of Treasury

4.8.2 Recent developments

Increasingly, requests for tax concessions are made on a project basis through project agreements. This is not the preferred tax policy approach. Tax concessions should be provided on an industry wide or sectoral basis, in order to ensure neutral tax treatment of competing firms in an industry.

There has also been a movement towards including in project agreements general tax concessions that are already contained in the existing tax law. In order to address this problem, the Government is embarking on an awareness campaign to inform all stakeholders of the various tax concessions available. All existing fiscal concessions have been compiled to ensure all stakeholders are aware of the availability of different sector-specific concessions as well as general concessions. These concessions are available in law and there is no need for investors to seek to have them included in project agreements.

4.8.3 Policy on Tax concessions

To ensure that future budgets are supported by a reliable revenue stream it is important that the tax base of the economy is maintained and not eroded.

The tax system is compromised when concessions are given to specific projects or taxpayers. The use of project agreements to create special tax arrangements for individual projects has encouraged a wide range of investors to seek a growing list of tax concessions.

To enhance the integrity of the tax system, concessions provided to projects need to be confined to those available for the relevant industry in the existing tax law. This would ensure neutral and equitable treatment of projects in each sector, and transparency in tax policy. The assurance of equitable treatment for all investors would encourage further overall investment in the economy.

4.9 OTHER MINOR TECHNICAL AMENDMENTS

As in previous years, a number of minor (non-policy) changes to the taxation laws have become necessary for various reasons — to improve the clarity of the tax laws, overcome interpretational issues, bring them into line with international agreements, streamline them and reduce compliance costs. In brief, the measures are:

1. Amendment of the of the Customs Act to:
 - ensure adequate notice is provided before actions can be brought against Customs officers; and
 - extend the definition of the offence of collusion to include activities such as colluding with agents to defraud the revenue or smuggle goods into Papua New Guinea.
2. Amendment of the Customs Act Regulations to give the Commissioner General of Internal Revenue the discretion to apply a lower licence fee.
3. Amendment of the Customs (Prohibited Exports) Regulation to impose restrictions on the exportation of Papua New Guinea currency, foreign currency or alluvial gold.
4. Amendment of the Customs (Prohibited Imports) Regulation to correct errors concerning intellectual property rights and to align the period of disposal with the period of suspension of clearance for suspected counterfeit goods.
5. Amendment of the Customs Tariff Tax Act to:
 - repeal the tariff classifications and replace them with a new set of tariff classifications that reflect updated international standards; and
 - reflect the cessation of manufacture in Papua New Guinea of “crown corks”.
6. Amendment of the Excise Act to:
 - impose a penalty on outstanding excise payments;
 - broaden the meaning of excise prosecution; and
 - improve the institution of prosecution penalties to reflect current practices.
7. Amendment of the Excise Tariff Act to:
 - remove the reference to “refinery gates” in the taxation of gasoline oil fuel (“zoom”); and
 - extend the temporary concessional excise rate for roll your own tobacco until 31 December 2009.
8. Amendment of the Income Tax Act to:

- ensure the collection of revenue is not impeded by the absence of a Commissioner General of the Internal Revenue Commission;
 - allow the Commissioner General to facilitate an exchange program with other jurisdictions;
 - remove now incorrect references to the VAT Act;
 - remove now incorrect references to the Organic Law on Integrity of Political Parties and Candidates;
 - extend accelerated depreciation to restaurants as intended by amendments contained in the 2006 Budget; and
 - clarify the order of deductions for Allowable Capital Expenditure.
9. Amendment of the Income Tax Act Regulations to add Abau, Aitape and Lake Kopiago districts to the list of districts for the purposes of the application of the Rural Development Incentive to implement NEC decision 161/2007.
10. Amendment of Schedules 4.2 and 4.4 of the Income Tax, Dividend (Withholding) Tax and Interest (Withholding) Tax Rates Act to clarify their application to non-resident corporations.
11. Amendment of the Rationalisation of the Public Service Act to extend the expiry date for imposition of a concessional rate of tax on redundancy payments to public servants to 31 December 2008.
12. Amendment of the Stamp Duties Act to clarify that the land rich provisions do not apply to share transfers where the company's asset is a resource licence.

CHAPTER 5. GROWING THE ECONOMY THROUGH SUSTAINED REFORM

5.1 OVERVIEW

The economy continues to grow strongly, with 2008 marking the sixth successive year of growth. This success is attributed to sound macroeconomic management, sustained reform and favourable global economic conditions. The economic progress in recent years needs to be sustained through further structural reforms and fiscal discipline.

PNG had made real progress in building a stable investment climate that has been achieved through stability in the political process and the Government's adherence to prudent fiscal and monetary policies.

To sustain economic growth, the Government is committed to promoting private sector growth. It will continue to address impediments to business and investments, improve competition in key sectors of the economy, open up the economy to markets and investment and improve public infrastructure.

The Government will continue to undertake critical public sector reforms, conduct sectoral reviews and corporatize state owned enterprises, remove impediments to investment, thus creating opportunities for further competition and private sector growth.

The 2008 Budget is framed upon an improving economy, political stability and a stable economy. It is guided by the Medium Term Fiscal Strategy (MTFS) outlined in Chapter 9. The Budget will continue to promote the Government's reform agendas in critical sectors through:

- Maintaining a stable investment climate;
- Enhancing competition and promoting private sector growth; and
- Improving efficiency, effectiveness and affordability of the public sector.

The Government will continue to pursue its reforms in relation to public service numbers and the payroll system. The Government is also committed to implementing best practices and transparency in financial management at all levels of government. It has taken significant steps in improving financial information and communication technology. These improvements were undertaken to support whole of government financial management systems. Substantial inroads have been made into improving financial management over the past years and further reform is in prospect.

The 2008 Budget will continue with improvements in expenditure control through the Public Expenditure Review and Rationalisation (PERR) program. It will continue to rationalize the number of trust accounts.

The Government recognizes the importance of continuing the district treasury roll out program. The program will continue in 2008 to provide government financial services and to complement the provision of basic services to rural areas under the enhanced District Service Improvement Program (DSIP).

Poor financial management, lack of transparency and governance are areas that still need to be addressed. A review was undertaken in 2005 and the process has been on-going. The Government will continue to address these issues in 2008. The Government has increased the amount and quality of public reporting, with the publication of the Final Budget Outcome and Mid Year Fiscal and Economic Outlook.

An initiative to be undertaken in 2008 will be the land reforms and the 2008 Budget allocates K28 million for this task. Poor management of land has been a hindrance to economic progress and investment. Some progress has been made in establishing the National Land Development Program to deal with land related issues.

5.2 A STABLE INVESTMENT CLIMATE

A stable investment climate is necessary for strong and sustained economic growth. Political, policy or macroeconomic instability can all make it difficult for businesses to plan and to make a well-reasoned assessment of the likely risk and returns on their investment. Under these conditions businesses will require a very high return on investment or, in many cases, will not invest at all.

PNG has made considerable progress in building a stable investment climate. The current Government has completed its full term and is now into its second term following a successful 2007 National Election. Political initiatives such as the enactment of the Organic Law on the Integrity of Political Parties and Candidates and the progressive introduction of Limited Preferential Voting (LPV) have improved stability of the political process.

The LPV system was used for the first time in the 2007 National Elections in PNG which resulted in a successful election outcome in terms of being free from post-election related conflicts and troubles. It was also a very positive development in that the 2007 National Election was conducted without a blow-out in Government expenditure that had been associated with some previous elections.

Stability in fiscal policy has improved, with the Government introducing, and adhering to, a range of medium-term policy frameworks, particularly the MTFs and the Medium Term Debt Strategy. The Government has also handled the challenge associated with windfall revenue arising from the commodity price boom well.

Macroeconomic stability has been improved through disciplined fiscal and monetary policies. Prudent macroeconomic policy settings have led to lower inflation and interest rates, and a more stable exchange rate. Appropriate wages policy has seen wage increases that are moderate and affordable. Prudent debt management has led to a more stable and less risky debt profile. Nevertheless, stronger economic growth and the commodity price boom is giving rise to inflationary pressure and this needs to be closely monitored.

In September 2007, the international credit rating agency, Standard and Poor's upgraded PNG's long-term foreign currency rating to B+ and its long-term local currency rating to BB- and the outlook was described as stable. The upgraded rating for PNG reflects improvement in the sovereign fiscal and external balance sheets and improved political stability.

The stable outlook on the ratings reflects PNG's improved economic prospects and is good for investor confidence as it has further raised PNG's creditworthiness in the global arena.

5.2.1 Prudent Fiscal Management

The 2007 Mid Year Economic and Fiscal Outlook (MYEFO) Report projected a budget surplus for 2007 of K1.2 billion, instead of a small deficit forecast in the 2007 Budget. This anticipated surplus was largely due to higher than estimated revenue collections, due mainly to high commodity prices. In October 2007 the Government announced a Supplementary Budget, which allocated substantial funds to investments in public infrastructure and in areas of the Government's priorities, and to meeting outstanding State obligations.

The Supplementary Budget in 2007 continued to support the Government's MTDS priorities with more than 75 per cent of the additional funds allocated to these areas. The expenditure items fall into three broad categories: MTDS priority projects; reducing outstanding State obligations; and other recurrent spending.

The 2007 Supplementary Budget targeted the following:

- | | |
|---|--------------|
| • Supplementing recurrent expenditure | K197 million |
| • Pre-funding public investment | |
| ○ Rehabilitating public infrastructure | K240 million |
| ○ New public infrastructure investment projects | K356 million |
| ○ Major improvements in infrastructure | K297 million |
| ○ Reducing superannuation liabilities | K250 million |
| ○ Repaying public debt | K297 million |

It is important that additional windfall revenue in 2007 and 2008 is not allocated in such a way that it becomes embedded in ongoing expenditure. This would make it difficult to manage recurrent expenditure in the future when revenues return to more normal levels. Rather, through the maintenance of fiscal discipline over ongoing expenditure, windfall gains are available to invest in the future of our nation. Funds used for the reduction of debt and other liabilities will free up future funds and reduce the vulnerability of the Government's financial position. The Government's debt situation has declined to 34.9 per cent of GDP in 2007 which is heading towards a more sustainable position.

On the revenue side, the Government has implemented the second round of tax cuts in 2007 that were announced in the 2006 Budget. The mining levy has been phased out completely as planned. The 2008 Budget further reduces tax impediments to business and provides personal income tax benefit with the greatest proportionate tax relief to low income earners.

Consistent with the 2007 Budget, an independent review of the Tariff Reduction Program was undertaken. The recommendations of the review are being considered and the Government will be announcing further tariff reforms once it has decided on the recommendations to be adopted.

In allocating additional mineral revenue over and above the original budget ceilings, the 2008 Budget maintains prudent fiscal management by allocating them to priority and one-off activities in nature. It has also taken care not build these revenues into ongoing expenditure. Details of these are provided in Chapter 2.

5.2.2 Fiscal Responsibility Act

To strengthen the medium-term framework for fiscal policies, the *Fiscal Responsibility Act* was enacted in August 2006. The Act contains a set of fiscal principles, which are to be applied through each Government's term of office. These principles are about sound fiscal management and implementation of the Government's Budgets. The Act stipulates that:

- Government agencies have regard to the provisions of the *Public Finances (Management) Act 1995* and the Financial Instructions issued under Section 117 of that Act;
- The Treasurer be consulted on any submission to the National Executive Council (NEC) that will have financial implication for the State, prior to consideration of the submission by the NEC; and
- Government agencies not be permitted to borrow funds without the prior approval of the Treasurer.

The Act also stipulates the release of three key fiscal reports each year. The reports include:

- A Final Budget Outcome Report;
- An Annual Budget Strategy Paper; and
- A Mid Year Economic and Fiscal Outlook Report.

As required by the Act, all three reports were completed and released in 2007. The publication of these reports represents a significant milestone in the Government's attempts to increase the transparency and accountability of its fiscal operations.

5.2.3 Affordable and Sustainable Wages Policy

The Government continues to support affordable wages policies, with increases in wages linked to productivity increases.

In late 2004 the Government negotiated a salaries and allowances agreement with the Public Employees' Association (PEA). The agreement was for a one-off payment and ongoing increases of 4 per cent per annum for three years. This was in addition to existing increment increases.

The 2004 Agreement expired in November 2006 and a new agreement covering the period 2007 to the end of 2009 has been negotiated with the PEA and was completed in October 2007. However, at the time of writing, the new agreement is yet to be endorsed by the NEC or signed with the PEA. In general terms, the proposed new agreement provides for wage increases which are expected to be mainly delivered over the three year agreement period via a proposed reformed increment structure. Criteria for increment advancement have been altered in an effort to tackle chronic absenteeism, poor attendance and under performance.

The affordable wage outcomes have been achieved by providing a range of improved non-wage benefits for public servants that can be provided at reasonable cost to Government. The proposed agreement also includes significant reforms that will enhance flexibility for both the Government and employees.

The proposed agreement is macroeconomically responsible in an environment of rising underlying inflation and will assist to reduce personal emolument expenditure as a percentage of total Government expenditure.

5.3 IMPROVING EFFICIENCY, EFFECTIVENESS AND AFFORDABILITY OF THE PUBLIC SECTOR

5.3.1 Streamlining Public Sector Resource Allocations

People have aspirations of higher living standards and improved well being, however these aspirations are hampered by poor public service delivery mechanisms. The scope of the Government's activities in PNG is very broad, with many of its operations not being adequately resourced. The Government's operations need to be streamlined and reduced, so that any savings derived are spent on priority activities.

As part of the aim to improve on service delivery, the Government undertook a review of the public sector agencies and their functions. The public sector review was undertaken by the Public Sector Reform Working Group (PSRWG) and the working group completed its report (the Rightsizing Report) in September 2005.

The NEC endorsed the principles and objectives of the Rightsizing Report in 2006. The Government deferred consideration of the Report's recommendations for abolishing or merging departments and functions until after the 2007 General Election. The rightsizing report will be considered again by the Government and a decision will be reached. Meanwhile, other recommendations of the Report are being pursued, notably those for rebalancing resources within each agency from administration to front-line service delivery, and from personnel remuneration to goods and services.

The ongoing programs under the public sector reforms are: the Functional and Expenditure Reviews, the Public Expenditure Review and Rationalization, Financial Management Improvement Program, the Service Improvement Program and the Capacity Building and Institutional Strengthening Program.

The Government's reform program is a five year rolling program and the current strategy will expire at the end of this year. The Public Sector Reform Management Unit (PSRMU) is now working on the new Road Map for public sector reform for 2008-2012 that encompasses wide ranging reforms of the public sector. Under the umbrella of this Road Map, the Rightsizing (merging and abolishing of departments and agencies) exercise will be continued in 2008. Both submissions (the Road Map and Rightsizing) are awaiting NEC's approval.

The 2008 Budget will continue to embrace the principles of the MTDS by concentrating recurrent resources in the priority areas of basic education, primary health, law and justice and infrastructure. The Government will also continue to identify savings from non-core areas to be spent on priority areas.

5.3.2 Equitable Resource Allocations to Provincial Governments

In mid 2006 the NEC agreed to a package of reforms to the *Organic Law on Provincial Governments and Local Level Governments* that would have changed provincial resource allocation for the 2008 budget. However, Parliament did not pass these reforms before the 2007 general election. The new Government has approved the re-introduction of the amendments to the Organic Law. It is expected that these amendments will be introduced in the November 2007 session of Parliament and that the new system will commence in the 2009 fiscal year.

The changes to provincial resource allocation introduced in the 2004 Budget have remained in place for the 2008 Budget – namely Function Grants, Block Grants, Derivation Grants, Staffing and Teachers' Grants, Rural Local Level Government Grants and Town Services Grants. Any funding for provincial and local-level governments above the 2007 level after allowing for increasing costs has been distributed to provinces on the basis of their needs.

The reforms being proposed by the National Economic and Fiscal Commission (NEFC), apply the principle in the NEFC's July 2005 *Report on the Review of Intergovernmental Financing* – that funding for service delivery in provinces should be matched as closely as possible to the actual cost of supplying those services, assessed for each province according to its circumstances.

The key features of the proposed new system will be:

- GST will be distributed to provinces, as now, according to where net inland GST is collected based on actual collections from the last complete year. Provinces will also receive 100 per cent of the bookmakers' tax collected in the province.
- All income received by provinces and local-level governments, except for taxes they raise themselves, will be taken into account in calculating the grants they receive from the national government.

- Provincial governments will receive service delivery function grants for goods and services. The amount of these grants will be based on need. This is designed to give more funding to those provinces which have less revenue from other sources. Once the system is phased in, each province will have a similar financial capacity to meet its service delivery needs.
- Funding for urban and rural local-level governments will also be based on their needs.
- It is expected that some additional funding will be phased in over the first five years. During this period, no province will receive less in grants and GST than it did the year before the new system started.

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

5.3.3 District Services Improvement Program (DSIP)

The DSIP's objective is to ensure that people are empowered by providing an opportunity for the majority to be engaged meaningfully in the development process and enhance their wellbeing. Taking part in the development process by the people should improve their quality of life and establish a sustainable standard of living for themselves and their children. The program was designed to have basic government services in each district.

The program is being implemented nationwide, and is focused on the provision of funding towards maintenance and upgrading of existing facilities at the district level. This means services are now brought to the door steps of the large bulk of the population and this will have the potential to generate high social and economic returns.

The national departments, government agencies and statutory bodies will be involved in the provision of basic services. Statutory bodies and business arms of the Government such as Post PNG, PNG Power, Telikom, the Water Board, various commodity boards, and Bank South Pacific will assist Government in providing services as part of their community service obligations.

The indicative annual contributions for each district is based on a Kina-for-Kina matching of funds and shall be as follows:

• Members of Parliament	K50,000
• Provincial Government	K50,000
• National Government	K100,000

Development partners such as donors are also expected to assist in financing.

The program is being implemented over a five year time period from the remainder of 2004 to 2008. The overall coordination is done by an Inter-agency Program Management Committee, with the Departments of National Planning and Monitoring, Works and Provincial and Local Level Governments taking the lead. The National Government's annual contribution to the program is K30.7 million.

The Government highly regards this program as a catalyst to economic growth and thus allocated an additional K356 million to the districts in the 2007 Supplementary Budget.

The Government has substantially increased funding to this program in the 2008 Budget by allocating an additional K534 million to the provinces.

5.3.4 Improving Governance and Accountability

A merit-based appointment system for departmental heads, provincial administrators and heads of statutory authorities has been put in place. This merit-based appointment system is intended to ensure more stable leadership across the public sector and improved accountability for the performance of government departments and agencies.

Continued support will be provided in the 2008 Budget for oversight agencies, including the Ombudsman Commission, the Office of the Auditor General and the Parliamentary Public Accounts Committee. These agencies provide external oversight of the public sector, supporting transparency in policies and processes, and strengthening accountability and compliance. The work of these agencies complements the reforms to internal controls in government departments and agencies.

5.3.5 Improving Governance and Accountability of Resource Rich Provinces

The Government is concerned about direct transfers from extractive industries to provincial governments, as some of those who receive transfers are not only underestimating these in their provincial budgets but are not always using them for productive purposes. A number of provinces where extractive industries are located and substantial transfers have occurred over the years are unable to show evidence of any improved level of development.

Currently, royalties paid by resource companies go directly to provincial governments and landowners as provided for by legislation and specified under Order Memorandums of Agreement. The accountability mechanisms for the transfer of these funds from resource companies to provincial governments are weak. Thus, there is a need for more accurate information and transparency of these transfers and receipts. This would assist both in the use of resource envelopes to provincial governments and for monitoring purposes by the National Government.

Initial discussions were held with the donor partners, particularly the World Bank on the Extractive Industries Transparency Initiative as a possible way to increase the transparency of payments for provincial governments. The Government is very supportive of this initiative and agrees that the provinces' ability to program and budget, as well as national ability to monitor would be aided by greater clarity on resource envelopes, intergovernmental transfers and line ministry budgets for expenditures at the provincial level.

The Government and its partners share the view that accurate information on resource transfers and receipts would help prevent leakage from provincial accounts. These are critical issues that need to be addressed in a carefully planned and co-ordinated manner, taking into account lessons from the application of the Extractive Industries Initiatives concept in other countries.

The Government is very supportive of this and will work in partnership with the World Bank and ADB in addressing the transparent use of transfers from extractive industries to the provinces in 2008.

5.3.6 Civil Service Size and Payroll Reform

Over the last four years, personal emoluments on average accounted for 40 per cent of total recurrent expenditure while goods and services accounted for only 33 per cent of recurrent expenditure. Trends over the years have shown that the annual appropriation to personal emoluments in the public sector have continued to rise.

Concerns over the public sector payroll dominating recurrent spending are not new. More effective control of public sector pay was seen as enabling re-direction of funds into growth promoting activities and priority areas. However, control over payroll does not appear to have improved in the intervening years. There has been limited past success in curbing public expenditure on salaries and wages through retrenchment, recruitment freezes and proposed pay cuts. Despite numerous reports and associated interventions, the impost on the budget from the public sector payroll is subject to tenuous control.

A key factor contributing to the excessive growth in staff numbers and cost has been lack of pressure on departments to keep within their budget appropriation for payroll. Control over payroll is a problem in the public sector and if not attended to could pose a serious threat to budget management and fiscal sustainability over the long term.

The Concept Payroll System has been installed in most public sector agencies and all provincial administrations. Even though the new Concept Payroll System has been installed, there appears to be breaches of the system. The breaches of the appointment process also appear to be a problem, and this is also having an adverse impact on controlling the public sector payroll. While existing measures through the Inter-Departmental Payroll Committee and to some extent through payroll monitoring are assisting, recent experiences have shown that a more effective system is needed.

5.3.7 Improving Financial Management

The Government has made substantial inroads into improving financial management over the past two years and further reform is in prospect. Broader reform of financial management is supported by the Financial Management Improvement Program (FMIP) and via the implementation of an Integrated Financial Management System (IFMS). The IFMS will transform the present planning and budget system and financial accounting and improve monitoring and reporting mechanisms for public sector financial management and accountability at all levels of government.

One of the challenges recognized by the Government is the need to have an over arching Public Financial Management reform strategy and work is underway through discussion and consultation to produce a Medium Term Financial Management Strategy. The Medium Term Financial Management Strategy will be provided to NEC as a draft for the consideration of Government, so that when approved, it will have a similar status to other NEC endorsed Medium Term Strategies.

Work is continuing on the roll out of an integrated Financial Management System. This will replace a situation where systems are not integrated but are linked. That is, the present Planning and Budget System (PBS) which executes the annual budget appropriated by the National Parliament is downloaded into the Treasury Management System (TMS) for expenditure monitoring and managing the annual public accounts.

Under the current arrangement, daily accounting transactions are uploaded which are processed through the stand alone PNG Government Accounting System (PGAS). This data will be migrated into the IFMS to be used as one single General Ledger.

In addition, as part of Government's overall plan to improve the integrated approach, it is intended to integrate the present Concept payroll and the Commonwealth Secretariat Debt Recording Management System (CS-DRMS) into IFMS to enable a single General Ledger to deliver whole of Government financial statistics. At present the legacy systems (PBS, TMS & PGAS) that are stand-alone do not provide whole of Government financial statistics.

Under the improved financial management of the Government, there is a plan to implement a uniform budget classification and chart of accounts to improve planning and budget that is linked to the Medium Term Development Strategy (MTDS) and accounting managed through a single General Ledger which will have Government Financial Statistics (GFS) reporting capability.

The IFMS will enable managers to manage, because they will have the available data and a system which is more responsive in time than the current non-integrated systems.

The challenge for Government is to ensure there is capacity building and skills transfer with sufficient staff trained to maintain and sustain the operation and management of the IFMS into the future. In addition, training officers have been identified to design, prepare and deliver training modules to key users and end users for the pilot site and non-pilot sites.

5.3.7.1 Better Expenditure Control

The Government is continuing to implement the Public Expenditure Review and Rationalization (PERR) Program. In particular, work has begun on PERR Project 9 which aims to provide a framework for the oversight and governance of statutory authorities. This work involves amending the Public Finances (Management) Act (PFMA) to clarify the application of the important accountability frameworks to all public bodies holding public assets or collecting public funds on behalf of the State. This work will ensure public bodies are subject to appropriate governance and accountability arrangements.

To improve expenditure controls in government agencies, Financial Controllers and Audit Committees were appointed to big spending departments, including Defence, Police, Foreign Affairs, Health, Education, Correctional Services and Petroleum and Energy. Thirteen Audit Committees have been established in national departments and statutory authorities as at June 2007.

As part of this exercise, amendments to the PFMA were sought to improve procurement and spending by public entities. In relation to this, section 39 of the PFMA was amended to allow the overhaul of the Central Supply and Tenders Boards (CSTB). The CSTB is now operating under the new Act, with all Provincial Supply and Tenders Board adhering to CSTB. With the amendments to the PFMA, this should improve expenditure controls within public entities.

5.7.3.2 Improving Financial Information and Communication Technology

Significant improvements to “Finance Information & Communication Technology” (ICT) infrastructure were undertaken during 2007. These important improvements were undertaken to support whole of Government financial management systems. This includes whole of Government payroll system, budgeting system (PBS), accounting system (TMS/PGAS), Integrated Financial Management System (IFMS), and other ancillary systems.

The installation of the major infrastructure improvements are:

- Enterprise Server and Storage Systems;
- Metropolitan Area Network (MAN);
- New Finance Data Centre; and
- The improvement of ICT Infrastructure Security

In addition to the above, the Department of Finance successfully carried out its operational duties to maintain and support all Government financial management systems (Payroll, PBS, TMS, PGAS, IFMS, etc.), and carried out capacity building and training of its ICT officers to support the ICT infrastructure and information systems.

2008 will be a period of consolidation and tuning the ICT infrastructure to better support whole of Government financial management systems, this will include:

- upgrade payroll system;
- stabilise PBS and TMS;
- stabilise PGAS;
- upgrade Finance HQ network to consolidate Finance Data Centre;
- rollout and commission of MAN to Departments;
- rollout and implement Citrix thin clients with the MAN;
- improve disaster recovery capabilities;
- enhancing blade servers to support additional users;
- enhancing the storage area network (SAN); and
- capacity building and training.

5.3.7.3 Rationalising Trust Accounts

The Government continues to rationalise the number of trust accounts to improve the way they are managed. Over the last two years the number of trust accounts in the public accounts has been reduced significantly, both in national and provincial departments and the exercise is ongoing. The 2006 and 2007 Supplementary Budget Trusts have been streamlined and with close consultation with the Departments of Treasury, National Planning and Prime Minister's Department have finalized the process for implementation of these funds.

5.3.7.4 Financial Reporting, Payroll and Trust Reforms

The Finance Department functions include the Payroll Accounting, General Ledgers, Trust Accounting and Accounting Frameworks.

The Public Accounts for the fiscal years 2004 and 2005 Public Accounts have been prepared and submitted for tabling in Parliament. Quarterly financial accounts for whole of government for 2003, 2004, 2005 and 2006 have been gazetted in the past year. The 2006 Public Accounts are finalized and the Audit is now underway. The Department is anticipated to move to comply with IFAC IPSAS² Cash Reporting Standard in preparation of Public Accounts as well as data cleansing of all balance sheet accounts to support migration of data to the IFMS and implementation of IFMS Accounting Modules.

In 2006, the Financial Management Manual (FMM) was launched and more than 2,000 copies of the Manual have been distributed to National Departments, Provincial Treasuries and Provincial Administrations. Further, the Department has also distributed 3,000 soft copies of the Manual and the Central Supply and Tenders Board Good Procurement Guide.

² IFAC IPSAS – IFAC International Public Sector Accounting Standards

Payroll monitoring is high on the agenda, with functional responsibility for Payroll Monitoring & Threshold Analysis and Reporting undertaken by the Finance Department. Implementation of online access of GoPNG payroll for National Departments and Public Bodies as well as implementation of tighter controls for batch processing of payroll variations has been undertaken, including improved investigation methods for historical payroll claims. Payroll has increased the use of Electronic Funds Transfer as a mode of payment for payroll, reducing the number of cheque payments and the associated processing costs.

Work is currently in progress in getting government line agencies to be computerized and use the National Government Accounting System PGAS. This is to ensure proper monitoring of trust accountability, management, control and reporting.

5.3.7.5 District Treasury Offices Roll Out

The District Treasury Office Roll Out is an important initiative of the Government and is being undertaken in accordance with the Organic Law on Provincial and Local Level Government. Section 112 of this law makes it mandatory for the establishment of District Treasuries. The aim of the roll out is to provide government financial services and to complement the provision of basic services to rural areas under the District Service Improvement Program (DSIP).

The Government continues to recognise the importance and sustainability of the District Treasury roll out program. It is desirable that the program continues in 2008, but the administration of the program is currently inadequate. The Government, through the Department of Finance has formulated a strategy in 2007 to ensure that the program is sufficiently administered.

To date, a total of 19 provinces have been covered and district treasury offices established in each district. About K52.0 million has been spent on the District Treasury Roll Out Program. The 2007 Supplementary Budget allocated K20.0 million for additional funding for existing district treasury offices and establishment and opening of Enga province district treasury offices.

For the District Treasury Roll Out Program to be fully implemented and functioning in the 89 districts nation wide, the Government has estimated a total cost of K53 million.

5.3.7.6 Non-Tax Revenue Management

Project 8 of Public Expenditure Review Rationalization is directed at improving non-tax revenue collection. Under this project, Revenue Division of the Department of Finance is continuously working on identifying issues and gaps in the revenue collection processes. The line departments are now more conscious of the regulatory controls applying to fees and charges and the importance of adhering to these controls. While progress has been made on fees and charges being recorded and credited to the Consolidated Revenue Fund, there are still strategies needed to bring in collections with minimum losses from various elements.

Work completed to date includes strengthening and streamlining reporting systems between provincial treasuries and line agencies, streamlining payment processes, particularly payment of court fines between various departments and agencies.

Other initiatives to be undertaken in 2008 to further improve revenue collection are the following:

- Development of a Revenue Training Module which will cover Revenue Management Controls under the Financial Management Manual;

- Installation of Computerized Receipting System in all the provincial treasuries;
- Installation of EFTPOS outlets in all the provincial treasuries and other revenue collecting sites. This will greatly reduce the danger associated with handling and transferring of cash;
- Appointment of Collectors and Receivers of Public Monies under the Department of Finance;
- Involving and networking with the provincial support assistant to link departments in the provinces with the provincial treasury operations at the provincial level;
- Developing an information pamphlet on frequently asked questions on Non-Tax Revenue;
- Development of clear guidelines on: irrecoverable revenues, retention of revenues, arrears recoveries, abolishing refunds and refund procedures;
- Follow up on changes to fees and charges submissions are now with the State Solicitor's Office. Efforts are continuing to get other line departments to make their submissions relating to their current fees and charges as well as other initiatives.
- Integrate non-taxation revenue requirements into the IFMS. This includes the provision of a complete database of all non-tax fees and charges which is a continuing process. This includes a comprehensive break-up of all existing fees and charges for all line departments and agencies. This will greatly enhance the Revenue Division's ability to monitor revenue collections at all levels of government. These will make the forecasting of non-tax revenue easier and more reliable.

5.3.8 Enhanced Cooperation Program (ECP)

Under the joint initiative of the PNG and Australian Governments, the Enhanced Cooperation Program (ECP) continued throughout 2007. The program focuses on efforts to promote and enhance law and order, good governance, sound financial management administration and capacity building within the PNG public sector. The program has been beneficial to participating government agencies and also enhanced bilateral ties between both governments. The program focuses within the economic and public administration, legal, and border protection and transport security sectors in the PNG public sector.

The PNG and Australian Governments have undertaken to jointly review the ECP Program in 2008. The outcome of this review will determine the next level of support or any improvements for the future program.

5.3.9 Statutory Authorities

The Government is concerned that financial management and governance within many of the statutory authorities is weak. Poor financial management and governance is at odds with the higher aim of government policy pertaining to fiscal sustainability and expenditure adjustment. While the PFMA provides for statutory authorities to submit financial statements to the Government annually, it appears that this is not often done.

The Government therefore intends to remedy this situation, and the process has begun with a review undertaken by the World Bank in September 2005. The review concluded that the main accountability systems exist but in practice their application is weak. The main causes of these problems are the large number and small size of statutory authorities, which make it difficult for the Auditor General and the Public Accounts Committee to effectively monitor their operations. In addition, assessments of these entities are inadequate even though current regulations allow for this under the PFMA. Accountability frameworks and models also differ widely among statutory authorities.

A component of PERR activity aims to improve expenditure control and realize savings by providing an improved framework and governance of statutory authorities. Within the overall aim of this project activity, the PERR Implementation Committee in consultation with development-partner stakeholders has undertaken to review the relevant provisions of the PFMA to ensure statutory authorities are held accountable for their operations. It will be necessary to review the individual Acts of statutory authorities to ensure consistency with the PFMA in relation to financial management, transparency and good governance, and to ensure proper fiscal oversight and budgetary controls are in place. Technical assistance has been sought from the Asian Development Bank to help undertake this review.

5.3.10 Land Reforms

It has been recognised over the years that poor management of land has been a major impediment to economic growth. The current process began with Land Summit in 2005.

Following the land summit, the Government introduced the National Land Development Program. The program focuses on land administration, land dispute resolution mechanisms and freeing-up customary land for development purposes.

Some progress has been made with the National Land Development Taskforce recommending the establishment of a single land court to deal with all land related issues and a Land Development Program Implementation Unit (LDPIU) to plan and manage the implementation. The NEC recently endorsed the establishment of the single land court and the work on it will continue into 2008. The committee is outsourcing the work of the program implementation unit to a private company. A private firm was engaged in July 2007 to provide costing and other related work for the unit. The Government is committed to the land development program and work will continue on this project into 2008 and beyond.

The 2008 Budget allocates K28 million to finance land reforms.

5.4 COMPETITIVE AND DYNAMIC PRIVATE SECTOR

Private sector growth is the key to job creation, higher incomes, and is a driver of economic growth. Through private sector development and competition, lower prices and better services for consumers and a more productive use of resources can be achieved. Strong institutions, a stable and enabling macroeconomic environment, appropriate regulation and efficient provision of public services are required to support private sector development.

The Government is committed to private sector growth and continues to work towards addressing impediments to businesses and investments, improving competition to key sectors, opening the economy to potential markets and investment, improving public infrastructure and supporting rural activities.

The Independent Consumer and Competition Commission (ICCC) is working to improve and enhance competition in a range of important industries. The public sector is also undergoing a range of reforms which will create opportunities for a more dynamic private sector, through sectoral reviews and the corporatization of state owned enterprises. Greater investment in public infrastructure will also assist with the growth of the private sector.

However, impediments to private sector growth remain and need to be addressed. Issues of law and order, corruption, land tenure issues, poor public service delivery, poor infrastructure and road maintenance, poor services from utilities, limited telecommunications and electrification remain as significant constraints on private sector development. These issues must be tackled in order for the private sector to grow and prosper.

5.4.1 Improving Competition

Increasing competition, efficiency and productivity in the economy spurs innovation, reduces prices, and improves quality of service delivery. Acknowledging that competition can contribute to economic growth and service delivery, the Government is taking a number of significant steps to improve competition throughout the economy.

The State's role in this process is to create an enabling environment for businesses to enter a market. This can involve removing impediments, such as monopoly powers, burdensome regulation, difficult licensing procedures and various other protective measures.

The ICCC was tasked with conducting important reviews into the aviation, coastal shipping, tourism and the telecommunications industries in 2006.

In 2007, ICCC was tasked to undertake comprehensive competition reviews into the General Insurance industry as well as the Wholesale and Retail trading sectors, with a particular focus on the level of competition and the premium and profit margins within these industries.

5.4.1.1 Telecommunications

In recent times significant progress have been made towards better telecommunication links. The ICCC has concluded the tender process for mobile competition and has issued new licences to two successful bidders in March 2007. These companies are Digicel PNG Limited and Green Communications Limited. Digicel has already commenced operations while Green Communications is expected to officially launch its operations before the end of 2007.

To ensure that there is fair and even handed competition among the new mobile operators and the incumbent operator, the ICCC has structured appropriate access guidelines, including an appropriate accounting separation guideline for Telikom to separate its mobile business from its fixed line and other businesses. The Telikom regulatory contract was also reviewed to reflect the change in circumstances in the industry.

Since the introduction of competition in the mobile segment of the industry, substantial social and economic benefits including improvements in the overall service levels have been realized within a short span of time. The number of mobile subscribers over the last year is estimated to have broadly doubled to be around 315,000. This represents a large and rapid overall improvement in market penetration of mobile services - which is continuing to grow rapidly. Significant cost savings have also been realized by users of mobile services, together with a much wider geographical area of coverage.

The entry of Digicel into the market has: improved efficiency and reliability of mobile services; lowered prices of mobile phone calls (which are purported to have fallen by around 50 per cent); significantly increased employment (which is reported to be in excess of one thousand) and has injected a substantial amount of capital into the economy. People in the rural areas of PNG are now accessing and enjoying more affordable mobile services brought on by competition. The expansion of mobile phone services in PNG - from both Telikom and Digicel - is estimated to be contributing around 0.7 percentage points to GDP growth in 2007. With the addition of GreenCom's expected rollout, the contribution of mobile phone expansion to GDP growth is expected to continue in 2008.

The Government has proposed a change in its Information and Communications Technology (ICT) policy to adopt vertical separation and only permit retail services competition. The implications of this change of policy are being examined.

The introduction of mobile phone competition in 2007, thereby ending Telikom's 50 year monopoly, is a significant milestone which will have far-reaching economic consequences. This is because telecommunication is an input into other businesses and performs an enabling function throughout the economy.

The introduction of competition in key sectors of the economy will create the impetus for wider competition in the national economy, and consequently assist private sector development. More competition provides great hope for PNG as the benefits of competition will flow to the majority of the people.

5.4.1.2 Aviation

Following the ICCC's comprehensive review into the aviation industry in 2006, the ICCC identified that the current code sharing agreement between Air Niugini and Qantas Airways on routes to and from Australia had the potential to substantially lessen competition. As a consequence of this finding, and an application from Air Niugini for renewal of the code share arrangement, a joint review of the arrangement has been established between the ICCC and the International Air Services Commission, the Australian Commission responsible for oversight of the airline industry. The ICCC's draft determination is expected to be released before the end of 2007.

Nevertheless, the international aviation sector now has two players and some international fares have fallen substantially. The tourism sector has begun to grow and, if sustained, this will mean additional income earning opportunities for people in rural areas.

The corporatisation of the Civil Aviation Authority (CAA) is an issue still to be resolved, including the transfer of assets and liabilities from the State to the CAA. Initiatives to separate the commercial functions of the CAA from its regulatory and safety functions are progressing. This would allow supervision of its commercial/market approaches or use of market power.

Recommendations to improve the transparency of performance of the CAA are being implemented so that a more business-focused approach, which involves transparency of performance of individual airports, can be introduced.

5.4.1.3 Shipping and Stevedoring

The ICCC commenced a review into the stevedoring industry in 2006. The final determinations will soon be released and among other things, is expected to include a new pricing arrangement to be based on efficient cost recovery, inclusive of a reasonable rate of return to reflect the risk borne by the industry. The proposed transfer of price regulation to the ICCC will also ensure appropriate monitoring of this important sector. These reforms, once implemented, will ensure a more cost effective stevedoring sector.

The review of coastal shipping, completed in 2006, made important recommendations to reform the Ministerial licensing advisory arrangements to remove any conflict of interest.

5.4.1.4 General Insurance

The ICCC was tasked by the Government to undertake a comprehensive review of competition and market conduct in the General Insurance industry. These reviews will assist the development of stronger institutions, appropriate regulations and efficient provision of public services, all of which are necessary to support private sector development. The ICCC found that there is a reasonable level of competition in the industry, with premiums reflecting to a larger extent, the market, economic and risk profile in PNG. Nonetheless, the ICCC has found serious legislative, regulatory and governance weaknesses in the industry that need to be addressed and strengthened going forward.

5.4.1.5 De-regulation of Certain Declared Goods

The ICCC also reported on the sundry goods inquiry. This review found that the current price regulation on most declared foods were unnecessary, as it was evident that there is a reasonable range and choice of these goods available for consumption. Competition was found to exist in these sectors, and hence the ICCC recommended removal of price regulation on batteries, butter, coffee, margarine, milk, poultry products, soap and tea. The de-regulated goods will now have their prices set and determined entirely by the market.

5.4.1.6 Electricity

Electricity outages are frequent and cost business and households millions of Kina in loss of production and add costs to business operations. This has been a longstanding concern for the private sector.

Introducing full competition in this industry is not a desirable action due to the nature of the industry and the economic and geographical circumstances. However, some progress has been made. In early 2007, the ICCC issued licences to PNG Sustainable Energy Limited, a subsidiary of PNG Sustainable Development Program, to be an electricity provider to be involved in the generation, distribution and retailing of electricity services in certain designated areas and towns in the Western Province.

An inter-departmental task force was established by the Government to develop a comprehensive industry policy to guide the development of this industry into the future. The 2008 Budget has provided an additional K30 million for rural electrification to be allocated according to the soon to be released electricity policy.

Inefficient and sub-standard provision of services by State owned utility enterprises have been a longstanding issue for business. However, a start has been made in the telecommunication sector. The provision of more efficient and affordable essential services, still needs to be addressed and this is still a work in progress.

5.4.1.7 Tourism

In 2006, the Government, through the ICCC and the Tourism Promotion Authority (TPA) requested that a comprehensive review of the tourism industry be undertaken and that a tourism master plan be developed, containing proposals for fostering the development of the industry. The final report and recommendations of this review were submitted to the Government in September 2006, and were formally adopted for implementation in May 2007.

A key recommendation of the review is the separation of the policy and marketing functions of the TPA. This is to be achieved through replacement of the existing TPA with a new industry driven body to oversee and co-ordinate destination marketing, called 'Tourism PNG'. Furthermore, a Tourism Policy Secretariat has been recommended to be established under the Ministry of Culture and Tourism to handle all policy matters. A Tourism Task Force Committee, headed by the Prime Minister, has been established to oversee the implementation of the review recommendations.

This ongoing reform in the tourism sector follows the announcement in the 2006 and 2007 Budgets of significant taxation concessions to this sector.

5.4.1.8 New Reviews

The ICCC has also been requested to undertake a review of the current pricing arrangement of Eda Ranu (the water authority) with a view to assessing their actual capital expenditure committed between 2005 and 2009 which was reflected in their tariffs. Depending on its findings, adjustments could be made to the pricing arrangements including the applicable tariffs.

The ICCC has commenced a review into the Public Motor Vehicle and Taxi fares currently applied in PNG. The final determinations will soon be released and will detail the pricing mechanism for buses and taxi fares which will be reflective of efficient costs incurred with a reasonable rate of return for the investment.

5.4.2 Improving Public Infrastructure

The poor state of public infrastructure continues to be an impediment to business. In particular, the poor state of roads is preventing accessibility to markets, particularly in rural areas.

The Government has made substantial commitments to improve public infrastructure. Airline infrastructure received a substantial boost in funding in the 2006 Budget, and K30 million has been provided towards the replacement of Air Niugini's fleet. An additional equity injection of K40 million has been committed by the Government, through the General Business Trust managed by the IPBC, for the purchase of an additional B767 aircraft.

The Government has prioritized improving services to rural areas, with significant funds being provided to improve rural electrification (with K30 million provided in the 2008 Budget) and rural telecommunications services, respectively. These services will see improved power and communications in the 20 least developed districts in PNG.

Opportunities for greater private sector investment in the generation of electricity continue to be examined. The Government has established an Electricity Policy Taskforce which is exploring options in this area and is currently working towards the development of a policy focused on improved efficiency and competition in the electricity sector.

Major capital investment projects are also underway in other Government-owned utilities. Eda Ranu, for instance, is scheduled to undertake K56.4 million in capital expenditure on an annual basis from 2005 to 2009. This capital works program is currently under review by the ICCC.

The Government acknowledges the importance of improving and maintaining public infrastructure by allocating K893 million for the 2007 Supplementary Budget. K240 million was provided for infrastructure maintenance, K356 million to support the District Service Improvement Program (DSIP) and K297 million to fund major improvements in infrastructure.

This has continued in the 2008 Budget with the Government allocating a total of K1,027.1 million for the additional work on improving and maintaining public infrastructure across the nation. The following outline shows these allocations from the 2008 Budget.

2008 Budget

Prefunding of Public Investment

- | | |
|--|--------------|
| • District Service Improvement Program
(with two new DSIP's of Transport and Agriculture) | K534 million |
| • Konebada Petroleum Park infrastructure- | K 50 million |
| • National Infrastructure Development Program- | K196 million |

Additional Priority Expenditure

- | | |
|---|---------------|
| • National Roads (additional to Development Budget) | K 50 million |
| • Rural electrification | K 30 million |
| • Tertiary institutions | K 30 million |
| • Public Housing | K 27 million |
| • Lae Roads | K 25 million |
| • Central City | K 20 million |
| • Border Development | K 20 million |
| • Technical schools maintenance | K 20 million |
| • Madang marine park | K 15 million |
| • South Bougainville feeder roads | K 4.1 million |
| • Lutheran university | K 3 million |
| • Buka-Arawa Rd | K 3 million |

The funds will be placed into trust funds as spending on the projects involved will be spread over time.

5.4.3 Improving the Regulatory Environment and Removing Impediments to Business and Investment

Appropriate, but not overly burdensome, regulation is an important complement to market development. The Government's policy is to continue with the reform measures introduced in the 2006 and 2007 Budget, focusing on removing impediments to business and investment.

The Government is continuing its efforts to remove impediments to business in order to encourage certainty, confidence, investment and growth in the economy. The Government is determined to allow the private sector to deliver economic growth by addressing regulatory impediments that currently constrain business activities.

The "National Working Group" on Removing Impediments to Business and Investment was set up by the Government several years ago to look at ways to lower the cost of doing business. This has had valuable results, such as efforts to reduce the number of days it takes to start a business. Similarly, the Investment Promotion Authority's foreign investment certification process, which deals with applications from foreign enterprises wishing to do business in PNG, after being initiated in 2006, will be strengthened in 2007.

The Government, through the National Working Group, will continue to address impediments to business and investment in PNG with a view to strengthening competition and where necessary, improving regulation. The Government has taken note of recent concerns about counterfeit products, which the import/export sub-committee of the National Working Group is considering.

In 2008 the Government is displaying its commitment to reducing impediments to business and investment with the removal of several stamp duties which it views as impeding business activity. The following stamp duties will be abolished in 2008:

- (i) Agreement or Contracts for Loans;
- (ii) Loan Securities, Mortgages and Foreign Securities;
- (iii) Credit Arrangements;
- (iv) Hire and Credit Purchase Agreements;
- (v) Bills of lading;
- (vi) Incorporating of Companies;
- (vii) Insurance policies; and
- (viii) Debits tax

However, PNG still lags behind other similar developing countries in terms of ease of doing business, according to the World Bank's latest report on Doing Business 2008. PNG ranked 84th among the 178 economies and even lagged behind Fiji, Vanuatu, Tonga, Samoa, Kiribati, Solomon Islands and Palau according to the document that investigates the regulations affecting business activity. This situation needs to be improved.

Regulatory supervision in the financial sector continues to be fine-tuned, especially in the superannuation industry. The Superannuation (*General Provisions*) (*Amendment*) Bill 2007 was passed by the Parliament in April 2007 to amend the Superannuation (General Provisions) Act 2000. These amendments enhanced effective regulation and prudential supervision of the superannuation industry. Some of the changes are about enforcement of employers' obligations, withdrawals of members' contribution to finance housing, and requirements for superannuation funds to make annual reports and disclosures to members.

The Department of Treasury and the Bank of Papua New Guinea will further review several related issues, including extension of superannuation coverage to the self employed and the informal sector, group cover life insurance, and the three-month waiting period for mandatory contributions. Consultations will be held among stakeholders to address the above outstanding issues.

5.4.3.1 Housing Policy

Following from the above-mentioned work in relation to land issues, a National Housing Policy Taskforce has been established by the Government. There is a clear relationship between the availability of land and security of title and a functioning housing market, and the private sector more generally.

The National Housing Policy Taskforce will formulate policy for the housing sector under the chairmanship of the Secretary of Treasury. The National Research Institute, which had earlier conducted a study into land reform, has been engaged to advise on this work.

This work will depend on the implementation of land reform, including improving the process for conversion of unregistered customary land to registered customary title, and then to urban development leases. This process requires substantial streamlining. Improvements in the registration of title and title issuing processes are also essential.

In the 2007 Supplementary Budget, the Government allocated K10 million to support institutional housing, K15 million for housing development and K15 million for an urbanisation program.

In the 2008 Budget the Government has further pre-funded the housing development with another K27 million which builds on the substantial commitment that Government has made to this area in the 2007 Supplementary Budget.

5.4.3.2 Improving the Openness of the Economy

Substantial reforms undertaken in, and since, 2005 towards freeing up flows of capital, labor, technology, goods and services into and out of the country, continue to benefit the PNG economy. Progress in opening up the market to direct investment flows continues, bringing much needed funds and skills into PNG.

5.4.3.3 Tariff Review

The Government commissioned a review into the current tariff policies in 2007. This work builds on the substantial reduction in tariffs undertaken in recent years. The recommendations of the 2007 Review are being considered and the Government is expected to be announcing the details of a further scheduled tariff reform in 2008, for implementation in 2009.

5.4.3.4 Gas Commercialization

The Government remains committed to the commercial development of our country's significant gas reserves. In this regard, the Government re-allocated K500 million in the 2007 Supplementary Budget and has further pre-funded another K100 million from the 2008 Budget for the State's future equity in the gas commercialization project. The funds will be put into a trust account to be utilized for this purpose.

A pro-active approach by the Government is needed in this sector but it should be one which ensures that commercial considerations shape the projects pursued in the gas and petroleum sector in the coming years.

Therefore, the Government will continue to play a facilitating role, offering private participants the opportunity to compete with each other to expedite the development of the gas sector. This means that there will be opportunities in this sector for investment.

Given the obligations that exploration and development companies have under various laws, the Government will continue to monitor developments and ensure that private parties meet their commitments and, consequently, that the interests of people are well served.

During 2007, a number of initiatives to commercialize the natural gas reserves have occurred. With the shelving of the PNG Gas Pipeline to Australia project, several proposals for alternative ways to develop the stranded gas fields in the southern part of PNG were proposed.

Apart from smaller project proposals for downstream activities, two proposals for Liquefied Natural Gas (LNG) projects were submitted to the Government. They are the Liquefied Niugini Gas Ltd LNG project and PNG LNG project.

The Liquefied Niugini Gas Ltd project is led by InterOil Ltd, Merrill Lynch and Global Pacific LNG. They have tabled a draft project agreement with the State and negotiations are progressing on fiscal terms and technical terms, especially on some of the concessions that they are seeking. The project involves building an LNG plant and a pipeline from the plant to the feed gas at Elk wells. This project is expected to cost around US\$6 billion. InterOil Ltd will develop the upstream Elk wells separately. InterOil is now in the process of proving up its reserves and having them certified.

The second LNG project is led by ExxonMobil with its co-venturers; Oil Search, AGL, Santos, Nippon Oil and MRDC. This project is based on the gas reserves from the previous PNG Gas Pipeline to Australia project plus a number of new wells. They have tabled a draft term sheet for negotiation with the State. The negotiation is continuing and is expected to be completed by the end of 2007. The project is expected to cost around US\$10 billion, which includes the cost of building the LNG plant, the pipeline from the gas fields to the plant and the development of the gas fields.

Both projects are working towards a 2011 first LNG shipment, as per the Prime Minister's announcement on the floor of Parliament.

The Government has some options and rights to take up equity in both LNG projects.

5.4.4 Supporting Rural Development Activities

The Government is committed to assisting the rural sector to ensure that the benefits of the commodity price boom are widely spread and benefit the majority of people living in the rural areas.

The 2007 Supplementary Budget maintained the high level support for the rural sector, including improved provision for basic services at the district level. The Government aims to address rural transport infrastructure, water supply, health, education and law & order. Each of the 89 Districts were allocated K4 million each from the K356 million allocated for DSIP.

In the 2008 Budget the government has continued building on its commitment of improving the lives of the people with the creation of two new DSIP's of transport and agriculture in all the 89 Districts and by providing further finance across all DSIP's. This will allow for more benefits to be spread across the nation with each of the 89 Districts to be allocated K6 million each across the six DSIP's from the K534 million allocated.

The 2007 Supplementary Budget combined with the 2008 Budget provides for a massive injection of K890 million into the districts. This will involve an enormous lift in responsibility and accountability at the district level.

In supporting rural finance under the DSIP, the Bank South Pacific has established branches in some of the recently established District Treasury offices.

The Government also allocated K297 million in the 2007 Supplementary Budget for major improvements in infrastructure such as upgrading and maintaining roads, major ports and wharves in order to enable easy access to markets.

The Government's Infrastructure Development Program announced by the Prime Minister in his State of the Nation Address on 18 September 2007 is another vehicle that the government will use in the next five years to improve the state of infrastructure in rural areas. With the transport component of the program being the largest the Government has allocated K196 million in the 2008 Budget where funds will be kept in trust funds and drawn down for implementation once NEC approves the new five year plan of the program.

A number of tax concessions that apply in the agriculture, forestry, fisheries and other sectors of the economy are described in Chapter 4. The Government will continue to take a pro-active approach to ensure these incentives are as effective as possible.

The Government will continue to explore and support micro-financing programs, which provide microfinance services and facilities to viable, small and medium-sized enterprises as well as to community based enterprises. The Microfinance Competence Centre will continue to develop institutional capacity of microfinance institutions (MFIs), including savings and loan societies, and micro-credit schemes.

New savings and loan products will be developed with a view to linking the informal sector of the economy, such as rural community saving groups or co-operative societies, with financial institutions. The successful establishment of Wau Microbank as a pilot scheme will become the hub of a network of MFIs in several parts of PNG, continuing to provide financial services to the rural population.

The agricultural sector continues to play a significant role in the economy, providing income and employment opportunities for 87 per cent of the population. The Government launched the National Agriculture Development Plan (NADP) 2007-2012 early in 2007 with the vision of having Government overcome various obstacles in the sector, thereby unleashing private sector growth. Key areas for intervention include: research and technical services (extension and information); food and horticulture; tree and industrial crops; livestock; apiculture and aquaculture; spices; and the strengthening of NADP management. The 2007 Supplementary Budget provided K40 million of funding for the NADP and the 2008 Budget provides an additional K28 million to bring total funds available for the NADP to K100 million.

The Government recognizes the importance of fisheries to the local market and the subsistence economy. The strategic area for development being pursued is in the establishment of more downstream processing of the catch. An integrated fishing/processing/marketing chain would return the greatest benefit to the economy. The key areas the sector is focusing on include: improved market access for fishery and marine products; improved marine product quality; improved research, development and dissemination of information; improved access to credit by fishermen; and building institutional capacity at the provincial and lower level governments to improve coastal fisheries management.

Forestry continues to be supported through tax concessions, including a reduction and simplification of the log export tax announced in the 2007 Budget.

The PNG Forest Authority recently launched its Corporate Plan 2007-2012, which provides strategic directions for the next five years. This plan will be continually reviewed to ensure that it is in line with the Government's development policies and the needs of the people, particularly the resource owners. Forest plantation development will be given close attention particularly: increasing plantable areas within the vicinity of existing plantations; management of over logged areas and downstream processing. Forestry research will be more focused and results oriented, leading to improved forestry administration.

The Government also increased funding in the 2007 Budget for protecting the environment in rural and marine areas, directed to administering environmental laws, to ensure that resources are developed and managed in a sustainable way.

CHAPTER 6. DEVELOPMENT STRATEGY

6.1 OVERVIEW

The Medium Term Development Strategy 2005-2010 (MTDS) continues to serve as the Government's overarching plan for the social and economic development of Papua New Guinea (PNG). The MTDS identifies seven Expenditure Priority Areas (EPAs) to guide public expenditure.

The seven EPAs are:

- Primary and Preventive Health
- HIV/AIDS Prevention
- Basic Education
- Development Oriented Adult Education
- Transport Rehabilitation and Maintenance
- Promotion of Income Earning Opportunities
- Law and Justice

The 7 EPAs each share two common features:

- They concern the basic needs of all Papua New Guineans: security, income, mobility, good health and schooling; and
- They require significant and increased financial resources.

It is for these reasons that the 7 EPAs represent the most urgent and fundamental spending priorities of Government.

While the MTDS identifies various other urgent reform agendas facing the country – Public Sector Reform, Public Expenditure Management, Macroeconomic Management, Governance, Environmental Protection, Gender Equality – these do not require significant public expenditure as part of their reform. Instead they require other solutions, such as stronger leadership, better policies and legislative reform.

6.2 INFORMING THE BUDGET WITH THE MTDS

In the 2007 Development Budget, Government developed a more strategic approach to its investment expenditure. This helped deliver a budget that was ultimately more responsive to the MTDS. This same approach is pursued further in the 2008 Budget.

This approach is structured around three policies:

- I. What share of Government's expenditure should be focussed on MTDS priorities;
- II. How expenditure should be spread across the seven EPAs to maximise the development returns; and
- III. What relationship the Government wishes to form between its spending and that of its development partners.

6.2.1 Aligning the Budget with the MTDS

The effective implementation of the MTDS requires that the proportion of the Budget allocated to the MTDS increases every year. A medium target has been set to increase MTDS alignment of all GoPNG expenditure – direct financing, tax credit and loans – from 48 per cent in 2005 to 55 per cent by 2010. For 2008, the Budget Strategy sets a target of no less than 53 per cent. A separate target of no less than 88.5 per cent is set for development expenditure alone in 2008.

The achievement of these targets requires Government to eliminate the funding of non-essential expenditure items and switch resources towards its priority areas.

6.2.2 Balancing Spending Across the Expenditure Priority Areas

Government endeavours to spread development expenditure across the seven EPAs in accordance with its *Sequencing Principle*. This Principle justifies timing spending to occur in one area prior to that in another, so as to maximise the net development returns, inclusive of all the EPAs. This is consistent with the goal of maximising allocative efficiency.

In practice, the Sequencing Principle means:

- Spending in areas with the greatest *spillover* effects on to other expenditure areas. For example, expenditure in transport rehabilitation supports the promotion of income earning opportunities.
- Spending in areas where there is a long *lag* between expenditure and outcomes. For example, achieving a high level of education throughout the country will take time and therefore requires us to begin investing now.
- Spending in areas to reduce *future cost* to Government and society. For example, promoting HIV/AIDS prevention to avoid the formidable cost associated with a country wide pandemic.

Incorporating each of the three sequencing considerations above generates a revised order for prioritising development expenditure over the 7 EPAs:

- Transport Rehabilitation and Maintenance
- Basic Education, Law and Justice, HIV/AIDS Prevention
- Primary and Preventative Health
- Development Oriented Adult Education, Promotion of Income Earning Opportunities

This applies to both GoPNG and donor expenditure.

6.2.3 Balancing Government and Donor Expenditure

Government endeavours to balance its expenditure with that of its development partners in accordance with its *Matching Funds Principle*. This Principle sees Government allocate its own expenditure to the EPAs in line with its preferred expenditure share. Development partners are then encouraged to imitate the Government's expenditure pattern, thereby scaling up the level of expenditure while reinforcing the share across the different EPAs.

The Matching Funds Principle maximizes the alignment of different funding parties, thereby enabling greater partnership and increasing the likelihood of total expenditure being spread optimally across the EPAs. Through this Principle, Government's own spending preferences provide a clear, unambiguous signal to development partners, enabling the Government to show leadership in determining patterns of development expenditure, whilst illustrating to civil society that the Government is serious about funding its own priorities. Government can therefore avoid the arbitrary funding arrangements which existed in the past, when Government limited itself to a peripheral funding role for some EPAs and left development partners to focus spending in their preferred areas.

6.3 THE MEDIUM TERM RESOURCE FRAMEWORK (MTRF)

The above three policies are used to inform Government and donors' expenditure decisions through the Medium Term Resource Framework (MTRF). The MTRF is a three-year expenditure planning tool for the MTDS. It assists GoPNG in achieving and managing an increased allocation of development expenditure towards the country's greatest priority needs by modelling the shape of future annual budgets and generating parameters which guide how appropriations can best be used.

The MTRF produces two important outputs:

- I. *Funding Gaps*, which provide a guide for the use of unallocated expenditure, based on a comparison of known future commitments to each EPA and the optimal affordable allocation to that EPA. These funding gaps refer to the total resource envelope – both GoPNG and donor – indicating the level of development expenditure that can be harnessed if GoPNG effectively coordinates all available funding. These funding gaps can assist donor expenditure planning (including the negotiation of new Country Strategies), improve coordination between different funding parties and serve as an early warning system for funding shortfalls. Calculations of the Funding Gaps for 2009 are provided in the table below.

Table 48: 2009 Funding Gaps (Kina Millions)

	Expenditure Commitments	Optimal Allocation	Funding Gaps
Primary and Preventive Health	158.9	194.9	36.1
HIV/AIDS Prevention	71.9	143.3	71.5
Basic Education	89.9	172.0	82.1
Development Oriented Adult Education	2.0	14.3	12.4
Transport Rehabilitation and Maintenance	448.2	614.9	166.8
Income Earning Opportunities	41.5	111.8	70.4
Law and Justice	92.0	182.0	90.1

Source: Department of National Planning and Monitoring

- II. *Indicative Sector Ceilings*, which set parameters for the optimal allocation of GoPNG's direct financing component of the Development Budget. Adherence to these parameters ensures that GoPNG meets its own target for the alignment of the Development Budget with the MTDS. Furthermore, the application of these ceilings provides a deliberate and rational shape to GoPNG spending patterns, avoiding a situation where individual items are deliberately funded but the overall picture is accidental or certain priority areas are neglected. Indicative Sector Ceilings for 2008 and 2009 are provided in the table 49.

Table 49: 2008 & 2009 Indicative Sector Ceilings (Kina Millions)

	2007 Budget Appropriations	2008 Indicative Sector Ceilings	2009 Draft Indicative Sector Ceilings
Primary and Preventive Health	45.0	33.8	36.8
HIV/AIDS Prevention	12.5	30.9	40.8
Basic Education	26.9	25.3	41.3
Development Oriented Adult Education	3.5	7.3	5.9
Transport Rehabilitation and Maintenance	159.8	156.3	143.1
Income Earning Opportunities	51.5	38.6	51.4
Law and Justice	30.5	46.9	45.9
Governance Reform	6.7	6.3	1.8
General Government Administration	2.3	2.1	0.6
Aid Administration	0.2	0.2	0.1
Constitutional Grants	54.5	54.5	54.5
Development Grants	97.3	97.3	97.3
Other Government Services	18.3	17.2	5.0
Total	509.1	516.7	524.5

Source: Department of National Planning and Monitoring

The MTRF and its two outputs already play a valuable role in enhancing the quality of Development Budget appropriations. Over time, efforts will be made to further integrate the central expenditure planning systems of the recurrent and development Budget to enable key service delivery agencies to better plan their sector expenditure.

6.4 PERFORMANCE MANAGEMENT FRAMEWORK

6.4.1 Introduction

Over the past 12 months, the Government has developed a Performance Management Framework (PMF) to monitor implementation of the MTDS. The MTDS PMF is a tool intended to track the country's rate of development and to determine the contribution of Government towards this end.

The MTDS PMF examines development in each of 13 MTDS PMF sectors:

- Primary and Preventative Health
- HIV/AIDS Prevention
- Basic Education
- Development Oriented Adult Informal Education
- Transport Infrastructure Rehabilitation and Maintenance
- Income Earning Opportunities
- Law and Justice
- Gender
- Environment
- Governance
- Public Sector Reform
- Public Expenditure Management
- Macroeconomic Management

For each sector, Government have identified a small selection of key performance indicators. Tracking the performance of these indicators focuses attention on the type and scope of interventions that can deliver change and the desired outcomes.

The MTDS PMF has two main outputs:

- I. A *Database* which contains each of the key performance indicators; and
- II. An annual report, or *Pocketbook*, which reports and interprets the performance of those indicators and assesses broader trends emerging from the data.

Beyond its value as a tool to determine the pace of development in PNG, the MTDS PMF is also intended to inform Budget decisions, by presenting policymakers with insight into the performance of key result areas and the need for remedial action in areas which are underperforming. Copies of the Pocketbook have therefore been made available to all decision-makers involved in scrutinising the Budget during its formulation.

Copies of the MTDS PMF Pocketbook will also be made available to a wider audience, including civil society. Development partners have expressed an interest in using the MTDS PMF to judge where their resources can most effectively be channelled and how their interventions are contributing towards the realization of the goals stated in the MTDS.

6.4.2 Results of the MTDS PMF

In the Pocketbook, the 13 MTDS PMF sectors are each awarded two overall grades, based on whether their indicators are improving or deteriorating. The first grade - the Trend - assesses indicators' performance over the full series of data from 2000 to present. The second grade - Latest Performance - assesses performance on the basis of the most recently observed data for each indicator. A positive score (between 1 and 5) indicates that development is taking place, with the majority of sector indicators showing signs of improvement. A negative score (between -1 and -5) indicates that the sector is in decline, with more signs of deterioration than improvement.

The illustrated scorecard provides the sector assessments for each of the 13 MTDS PMF sectors. Performance is mixed with some sectors showing consistent improvement (Macroeconomy, Public Expenditure Management) while others show evidence of decline (Governance). Some sectors have experienced a recent

turnaround in performance (Health, Transport, Gender) whereas in others, progress appears to have stalled (Public Sector Reform). The Trend assessment judges that, on aggregate, there has been no discernible development since the year 2000. The improvements that have occurred can be weighed up against a worsening performance in an equal number of areas. In contrast, the Latest Performance assessment reveals that, on the latest evidence, most sectors are now beginning to improve their performance. It is hoped that this positive finding will be reinforced by evidence of further improvement in next year's review.

MTDS PMF Sector	Trend	Latest Performance
Primary and Preventative Health	-2	2
HIV/AIDS Prevention	0	0
Basic Education	1	1
Development Oriented Adult Education	-3	3
Transport Maintenance and Rehabilitation	0	2
Income Earning Opportunities	1	0
Law and Justice	-2	-1
Gender	0	2
Environment	1	0
Macroeconomy	4	5
Governance	-3	-1
Public Expenditure Management	2	3
Public Sector Reform	1	-1
Average	0	1

6.5 FUTURE DEVELOPMENT BUDGETS

The Government will continue to rely on the MTDS and its associated policies to guide its development expenditure over the coming years. In addition, the findings of the MTDS PMF have drawn attention to some of the major challenges which remain if the MTDS is to be effectively implemented:

6.5.1 Revitalising essential mechanisms for service delivery

Key service delivery sectors rely on the functioning of various mechanisms or systems which underpin their performance. For instance, in the health sector, some of these mechanisms include:

- Using sector human resource assessments to determine the recruitment of new healthcare professionals
- Using sector human resource assessments to determine the allocation of personnel to health centres
- The organisation of medical officer visits to health centres
- The supply of drugs to health centres
- The conducting of outreach clinics
- The collection and reporting of health centre data

In sectors which present significant logistical and managerial challenges, such as health, the importance of having effective mechanisms in place cannot be overstated. However, in most sectors, once reliable mechanisms have either stopped functioning effectively or have been rendered inadequate over time. Revitalising simple but effective mechanisms is a crucial part of turning around the performance of struggling service delivery sectors.

6.5.2 Reforming Government's approach to maintenance

One such mechanism which requires significant reform is Government's approach to infrastructure maintenance. Traditionally, maintenance budgets have been too small to finance necessary works. Where funds have been appropriated, these have easily been diverted for alternative, more immediate needs. These failures demonstrate a more fundamental failure in the approach to maintenance: the value of routine maintenance is not always immediately apparent and decision-makers have therefore been able to rationalize cuts in maintenance budgets, especially when funds are low and infrastructure is still functioning.

With routine maintenance inadequately managed, infrastructure assets have been allowed to slowly run down, to the point where they become obsolete. However, in recent years, the Government has shown increased recognition of the importance of public infrastructure. Infrastructure rehabilitation features prominently in the MTDS and has been substantiated with major appropriations in recent Development Budgets and Supplementary Budgets. Care must be taken, however, to prevent Government entering into a vicious cycle of rehabilitation and neglect of infrastructure. This approach is inefficient and places unnecessary costs on Government.

An improved approach to infrastructure maintenance would involve:

- Maintaining an inventory of all the public infrastructure assets in a sector;
- Valuing each asset;
- Calculating the annual maintenance needs of each asset, based on its value and a depreciation rate;
- Determining the current state of each asset and any rehabilitation needs; and
- Providing a rational basis by which rehabilitation and maintenance requirements are prioritised.

Such a system is already in place for National Roads: the Road Asset Management System (RAMS). This type of approach should be rolled out to other infrastructure assets of Government. Consideration should also be given to:

- Ensuring that there are clear incentives to carry out routine maintenance works;
- Specifying responsibilities and clear accountability mechanisms for carrying out maintenance works; and
- Establishing the process by which any new asset management systems can be managed and regularly updated.

6.5.3 Designing credible plans for rolling out services

The MTDS requires Government to roll out essential services to under-served areas. This poses a mammoth task. Such areas are usually remote and at present lack the most basic infrastructure. Capacity constraints in both the public and private sector make the task greater still. Determining the least cost approach to rolling out services and ensuring that new services are sustainable will emerge as one of Government's greatest challenges over the coming years.

6.6 DEVELOPMENT BUDGET 2008

Table 50 illustrates the summary data for the 2008 Development Budget. Of a total Development Budget of K1,887.1 million, K763.4 million originates from Government sources, whilst K1,123.7 million is contributed by development partners. K1,349.5 million of the total Development Budget is directly targeted at the seven MTDS EPAs.

Table 50: 2008 Development Expenditure (Kina Millions)

	2008 GoPNG	2008 Grants	2008 Total
MTDS Expenditure Priority Areas	499.7	849.8	1,349.5
Other	263.7	273.9	537.6
TOTAL	763.4	1,123.7	1,887.1

Source: Department of National Planning and Monitoring

The Government's contribution to the Development Budget comes in three forms: direct financing, Tax Credit Scheme and loans. The Tax Credit Scheme and loans are predominantly used for Transport Maintenance and Rehabilitation whereas the Government's direct financing is targeted across the seven EPAs.

Table 51: 2008 GoPNG Development Expenditure on MTDS Expenditure Priority Areas (Kina Millions)

	Direct Financing	Tax Credit	Loans	Total GoPNG
Primary and Preventive Health	34.8	0.0	9.2	44.0
HIV/AIDS Prevention	17.0	0.0	0.0	17.0
Basic Education	10.5	0.0	0.0	10.5
Dev-Oriented Adult Education	3.3	0.0	0.4	3.7
Transport Rehab and Maintenance	148.0	73.7	116.4	338.1
Income Earning Opportunities	38.4	0.0	17.0	55.5
Law and Justice	31.0	0.0	0.0	31.0
Sub-Total	283.0	73.7	143.0	499.7
Other	243.7	0.0	20.0	263.7
TOTAL	526.7	73.7	163.0	763.4

Source: Department of National Planning and Monitoring

Table 52 below shows the level of direct financing to each of the seven EPAs in 2008 relative to funding in 2007.

Table 52: 2008 versus 2007 GoPNG Development Expenditure Direct Financing on MTDS Expenditure Priority Areas (Kina Millions)

	2007 GoPNG	2008 GoPNG	Change	Change (%)
Primary and Preventive Health	45.0	34.8	-10.2	-22.7%
HIV/AIDS Prevention	12.5	17.0	4.5	36.0%
Basic Education	26.9	10.5	-16.4	-61.0%
Dev-Oriented Adult Education	3.5	3.3	-0.2	-5.7%
Transport Rehab and Maintenance	159.8	148.0	-11.8	-7.4%
Income Earning Opportunities	51.5	38.4	-13.1	-25.4%
Law and Justice	30.5	31.0	0.5	1.6%
Sub-Total	329.8	283.0	-46.8	-14.2%
Other	179.3	243.7	64.4	35.9%
TOTAL	509.1	526.7	17.6	3.5%

Source: Department of National Planning and Monitoring

The majority of the Government's expenditure outside of the seven EPAs is for constitutional grants (District Support Grants) and development grants (Special Support Grants (SSGs), Memorandum of Agreements (MoAs) and the Bougainville Peace Agreement. Appropriations for development grants are again high in 2008 due to buoyant production levels across Papua New Guinea's extractive industries increasing the value of SSGs and greater commitment by Government to budget for its MoA commitments. It is estimated that the majority of both constitutional and development grants are ultimately expended on MTDS aligned projects and initiatives.

Table 53: 2008 GoPNG Development Expenditure Outside of MTDS Expenditure Priority Areas (Kina Millions)

	Direct Financing	Tax Credit	Loans	Total GoPNG
Governance Reform	16.1	0.0	15.3	31.4
General Government Administration	10.8	0.0	0.0	10.8
Aid Administration	0.0	0.0	0.0	0.0
Constitutional Grants	54.5	0.0	0.0	54.5
Development Grants	133.0	0.0	0.0	133.0
Other Government Services	29.3	0.0	4.7	34.0
TOTAL	243.7	0.0	20.0	263.7

Source: Department of National Planning and Monitoring

In all, 82.7 per cent of GoPNG expenditure in the 2008 Development Budget is estimated as being MTDS aligned. This compares to GoPNG's target of 88.5 per cent.

As in 2007, the Government has used indicative sector ceilings generated by the MTRF to guide its direct financing. Performance against these ceilings is detailed in the table 54.

Table 54: Performance against 2008 Indicative Sector Ceilings (Kina Millions)

	2008 Indicative Sector Ceilings	2008 Budget Appropriations	Difference
Primary and Preventive Health	33.8	34.8	1.0
HIV/AIDS Prevention	30.9	17.0	-13.9
Basic Education	25.3	10.5	-14.8
Development Oriented Adult Education	7.3	3.3	-4.0
Transport Rehabilitation and Maintenance	156.3	148.0	-8.3
Income Earning Opportunities	38.6	38.4	-0.2
Law and Justice	46.9	31.0	-15.9
Governance Reform	6.3	16.1	9.8
General Government Administration	2.1	10.8	8.7
Aid Administration	0.2	0.0	-0.2
Constitutional Grants	54.5	54.5	0.0
Development Grants	97.3	133.0	35.7
Other Government Services	17.2	29.3	12.1
TOTAL	516.7	526.7	10.0

Source: Department of National Planning and Monitoring

The ratio of GoPNG to donor expenditure is mixed due to an increase in donor expenditure and GoPNG development expenditure outside of the 7 EPAs.

Table 55: 2008 GoPNG Development Expenditure Versus Donor Expenditure (Kina Millions)

	2008 GoPNG Development	2008 Donor Grants	2007 Ratio	2008 Ratio
Primary and Preventive Health	44.0	132.0	1:2	1:3
HIV/AIDS Prevention	17.0	84.3	1:8	1:5
Basic Education	10.5	163.1	1:3	1:16
Dev-Oriented Adult Education	3.7	0.0	4:1	-
Transport Rehab and Maintenance	338.1	220.8	2:1	2:1
Income Earning Opportunities	55.5	141.4	1:1	1:3
Law and Justice	31.0	108.3	1:2	1:3
TOTAL/AVERAGE	499.7	849.8	1:1	1:2

Source: Department of National Planning and Monitoring

When account is also taken of recurrent and the additional priority expenditure, it can be seen that the Government is the lead financier in six out of the seven EPAs. It is envisaged that the trend towards greater Government leadership in terms of financing will coincide with the Government taking greater responsibility for service delivery in each of these priority areas.

**Table 56: 2008 GoPNG Total Expenditure Versus Donor Expenditure
(Kina Millions)**

	2008 GoPNG Recurrent & Development	2008 Donor Grants	2007 Ratio	2008 Ratio
Primary and Preventive Health	679.7	132.0	5:1	5:1
HIV/AIDS Prevention	22.7	84.3	1:5	1:4
Basic Education	713.7	163.1	8:1	4:1
Dev-Oriented Adult Education	19.5	0.0	10:1	-
Transport Rehab and Maintenance	623.9	220.8	3:1	3:1
Income Earning Opportunities	456.3	141.4	3:1	3:1
Law and Justice	503.7	108.3	7:1	5:1
TOTAL/AVERAGE	3,019.6	849.8	4:1	4:1

Source: Department of National Planning and Monitoring, Department of Treasury

CHAPTER 7. SECTORAL POLICIES

7.1 OVERVIEW

The MTDS is the Government's overall guide to development planning and spending. The MTDS sets the overarching development strategy under which sectoral policies and plans are developed, specifying the most effective approach to Government intervention.

This Chapter first reviews activity under each of the seven MTDS Expenditure Priority Areas (EPAs), namely:

- Primary and Preventative Health Care
- HIV/AIDS Prevention
- Basic Education
- Development Oriented Adult Education
- Transport Rehabilitation and Maintenance
- Promotion of Income Earning Opportunities
- Law and Justice

It also lists the major development expenditure items under each of the seven priority areas.

The Chapter then turns to a review of Papua New Guinea's key economic sectors, as identified in the MTDS. These are Papua New Guinea's developing renewable resource sectors and its traditional sectors:

- Agriculture
- Forestry
- Fisheries
- Tourism
- Oil and Gas
- Mining
- Manufacturing

7.2 MTDS EXPENDITURE PRIORITY AREAS

7.2.1 Primary and Preventative Health Care

The National Health Plan 2001-2010 continues to serve as the overarching plan for the Government's interventions in the health sector. The Strategic Plan for the PNG Health Sector 2006-2008 provides the basis for a more focussed effort on the immediate pressures facing the sector. This identifies a number of key challenges affecting health care in PNG: the declining health of rural women and children; limited resources; limited or non-existent access to basic health services; deteriorating infrastructure; inefficient management; low staff morale; and low community and individual response to health services.

The scope of these challenges are evidenced in the MTDS Performance Management Framework, which highlights the declining access to healthcare, the low and falling share of births which are supervised (35%) and the unavailability of drugs at aid posts for - on average, 5 months of the year - due to unsatisfactory dispersion mechanisms. In contrast, the report reveals improving immunisation rates (particularly for Triple Antigen (77 per cent)) and satisfactory reporting by health centres.

Underlying the problems of the sector are a number of broader issues. The devolution of responsibilities through the Organic Law has naturally weakened vertical links within the sector, some of which are crucial to the smooth running of the sector. The sector coordination mechanism for pooling funds - the Health Services Improvement Program (HSIP) – has been thwarted by difficulties, resulting in an inability to spend. Less than 40 per cent of available funds were expended in 2006. Staffing at both national and provincial levels is problematic, with varying quality of provincial health advisors and several HSIP Management Branch roles left vacant. The latter problem partly reflects the weak coordination between the central agencies and the Department of Health – an issue where efforts have already begun to rectify the situation with the revitalising of the central agencies committee on health.

A major initiative of the Strategic Plan has been to better prioritise health sector interventions. The sector's Medium Term Expenditure Framework serves an important role in this effort, ensuring adequate funding to key health interventions, including immunisation, malaria prevention (bed nets and spraying), safe motherhood/family planning. These reflect the priorities of the Strategic Plan. Second level priorities include other major communicable diseases, while third level priorities cover the remaining clinical and public health programs/services.

The table below details the level of development expenditure to the health sector (excluding to HIV/AIDS) over the past 5 years. This shows the increasing commitment of GoPNG investment to the sector, which, over time, should facilitate greater Government leadership. In addition, the large Supplementary Budget appropriations for the rehabilitation of health sector infrastructure offer an opportunity for the Government to revise the previously inadequate approach to asset management.

Table 57: Development Expenditure on Primary and Preventative Health 2003-2008 (Kina Millions)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	21.1	0.0	6.5	131.2	158.7
2004	5.9	0.0	2.3	118.5	126.7
2005	8.3	0.0	15.0	126.1	149.4
2006	28.8	0.0	17.0	114.3	160.1
2007	45.0	0.0	3.0	113.3	161.3
2008	34.8	0.0	9.2	132.0	176.0

Source: Department of National Planning and Monitoring

The 2008 Development Budget will continue the Strategic Plan's focus on the areas of malaria, safe motherhood, immunisation, tuberculosis and HIV/STIs. Ongoing reforms in the health sector will intensify efforts on:

- Human resource planning including capacity mapping and subsequent building of management skills;
- Implementation of the streamlining of provincial health services including delegations of authority to provincial health advisers and Department of Health organizational reforms to support this streamlining;
- Securing minimum levels of provincial health funding and strengthening the use of the sectoral resource allocation model/process;
- Improving hospital efficiencies (including user fee collection and medical equipment and sterilizer management); and
- Medical supply logistics management reform (procurement, distribution etc).

The major items in the 2008 Development Budget specific to this expenditure priority area are shown in table 58.

Table 58: 2008 Development Expenditure on Primary and Preventative Health (Kina Millions)

	2008 GoPNG	2008 Donor	2008 Total
Capacity Building Service Centre	0.0	35.7	35.7
Rural Water Supply and Sanitation	0.0	33.2	33.2
Health Sector Resourcing Framework	0.0	24.0	24.0
Health Sector Improvement Programme (HSIP)	10.0	8.7	18.7
Provincial Towns Water Supply and Sanitation	17.8	0.0	17.8
Purchase of Medical Equipment	12.0	0.0	12.0
Other	4.2	30.4	34.6
Total	44.0	132.0	176.0

Source: Department of National Planning and Monitoring

7.2.2 HIV/AIDS Prevention

The HIV/AIDS virus has demonstrated its potential to undermine economic and social advancement in a number of countries. Based on the alarming projections for the spread of the epidemic in PNG, it is in these terms that GoPNG is now responding to the virus.

A new report on HIV/AIDS situation in PNG was released by National Aids Council Secretariat (NACS) and the Department of Health in August 2007. The report provides new insights on the state of the epidemic. It shows that while overall HIV/AIDS prevalence is lower than was previously estimated - generally due to improvement in the quality of data, coverage and reporting - the epidemic has continued to rise unabated. Overall HIV/AIDS prevalence at the end of 2006 was 1.28 per cent and is projected to rise to 1.61 per cent by the end of 2007. The epidemic is generalised and firmly established in both rural and urban areas and within all segments of the population. Of major concern, the report reveals that the epidemic is sharply rising in the rural areas where the majority of the population lives, contrary to previous belief that HIV/AIDS in PNG was concentrated in urban areas. The report shows worsening performance on all key indicators: people living with the virus, cases of new infection, AIDS related deaths and the numbers of AIDS orphans.

The report also indicates the need to significantly scale up prevention, treatment and care efforts in the rural areas where the epidemic is fast spreading. Women - particularly young girls aged 15-24 years - are the new faces of the epidemic. More efforts are required in tackling the link between gender and HIV/AIDS.

The National Strategic Plan on HIV and AIDS provides the broad framework for all organizations to respond to the epidemic within their own capacity, including the Government. The overall goal of the Plan is "To reduce the HIV prevalence in the general population to below one per cent by 2008, improve care for those infected, and minimise the social and economic impact of the epidemic on individuals, families and communities", a goal which appears increasingly elusive based on the latest evidence of the spread of the disease. The strategic framework focuses on seven main areas for intervention: treatment, counselling, care and support; education and prevention; epidemiology and surveillance; social and behavioural change research, leadership, partnership and coordination; family and community support; and monitoring and evaluation.

How the plan is implemented has had to change given the changing dynamics of the HIV/AIDS epidemic, with treatment and family and community support emerging as an increasingly crucial component of the response. While it is important that all aspects of the epidemic are addressed, leadership, partnership and coordination, education and prevention and monitoring and evaluation have become the most pressing priorities.

In the past year, progress has been made with regard to the transformation of NACS from its previous involvement with implementation to that of a coordinating body. Key areas of progress and achievement in 2007 include institutional restructuring to define an ideal structure for coordination and the development of internal policies relating to finance, human resources, procurement, information technology, communications and grant policies.

Improving data collection and analysis remains a critical need for the sector. The development of a monitoring and evaluation framework in 2007 represents an important milestone towards this end. Other areas of recent progress include the approval of the NACS Amendment Act 2007, which is expected to strengthen NACS coordination and leadership role in the national response.

The budgetary allocations reported in the Development Budget since 2003 shows that funding support for HIV/AIDS prevention is dominated by grants with limited but now increasing direct GoPNG funding.

Table 59: Development Expenditure on HIV/AIDS Prevention 2003-2008
(Kina Millions)

	Direct				
	Financing	Tax Credit	Loans	Grants	Total
2003	0.3	0.0	0.0	27.1	27.4
2004	0.3	0.0	0.0	26.5	26.8
2005	1.0	0.0	0.0	9.5	10.5
2006	3.0	0.0	0.0	40.6	40.6
2007	12.5	0.0	0.0	78.3	90.8
2008	17.0	0.0	0.0	84.3	101.3

Source: Department of National Planning and Monitoring

In 2008, Government's funding to NACS will focus on improving the capacity of NACS and the Provincial AIDS Committees to lead, coordinate, manage and monitor the national response at all levels. It is also earmarked for priority research activities determined through the Research Advisory Committee in line with the national research agenda. Funding from PNG's development partners will continue to be directed towards service delivery provided by both GoPNG Departments and larger NGOs.

The major items in the 2008 Development Budget specific to this expenditure priority area are shown below.

Table 60: 2008 Development Expenditure on HIV/AIDS Prevention
(Kina Millions)

	2008 GoPNG	2008 Donor	2008 Total
PNG-Australia HIV/AIDS Support Program	0.0	48.0	48.0
Health Program response to HIV Sector	0.0	20.4	20.4
Implementation of National Strategic Plan on HIV/AIDS	16.5	0.0	16.5
HIV/AIDS Prevention and Control in Rural Dev. Enclaves	0.5	11.9	12.4
ADB Social Marketing for Condoms	0.0	3.9	3.9
Total	17.0	84.3	101.3

Source: Department of National Planning and Monitoring

7.2.3 Basic Education

The National Education Plan 2005—2014 is guided by the National Goals and Directive Principles in the Constitution. The first priority of the current Plan is to provide the opportunity of nine years of basic education for all. This is consistent with the MTDS 2005-2010 target and in line with Goal 2 of the Millennium Development Goals, which is to achieve Universal Primary Education (UPE) by 2015.

The three components of UPE are that:

- All children should begin formal primary schooling (EP1) by the age of seven;
- All children should complete the primary cycle of education (which in PNG is to the end of grade 8); and
- All children should reach a required standard of literacy and numeracy at the end of this primary cycle of education.

Since the year 2000, the number of children beginning their schooling each year (EP1) has shown little discernible change, while the share of those who persevere through to the final year of their primary education (G8) has increased markedly. Girls have been a major beneficiary of this increased retention, resulting in greater gender equality in schooling. A shift to UPE would require retention rates to continue improving, while access to those who currently fail even to start their schooling will have to be made possible. In addition to accommodating these increased numbers, the sector will also have to position itself to absorb the steady increase in pupils, commensurate with population growth. Affordability and the process of rolling out of services in under-served areas are two of the major challenges to achieving UPE.

Accommodating the increasing number of school children is crucial to ensure that quality is not compromised. Since 2001, average class sizes have increased, though they remain close to target, at present. One means of preserving the quality of education is through school inspections. The number of inspections taking place is increasing and the National Department of Education (NDOE) has placed significant emphasis on training inspectors and conducting inspection visits during 2007.

The total appropriations to Basic Education from the year 2003 to 2007 are shown in the table below. Government's share of funding has increased significantly over this period, boosted further by the large injection of funds made possible by the 2007 Supplementary Budget for the Rehabilitation of Education Sector Infrastructure program, aimed at National High Schools, Provincial Secondary Schools, Vocational and Technical Schools, as well as Primary Schools. Of 3,416 Primary and Community Schools in PNG, some 1,047 schools are to be assisted from this funding. Plans for the expenditure of these funds have been developed in 2007 and it is expected that the first funds will be expended in 2008. Work has also progressed under the Basic Education Development Project to encourage school's self-reliance in relation to infrastructure management.

Table 61: Development Expenditure on Basic Education 2003-2008
(Kina Millions)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	2.7	0.0	0.0	69.0	71.8
2004	5.9	0.0	0.0	141.5	147.4
2005	5.7	10.0	0.0	170.4	186.1
2006	14.4	0.0	0.0	151.1	151.1
2007	26.9	0.0	0.0	74.4	101.3
2008	10.5	0.0	0.0	161.3	173.5

Source: Department of National Planning and Monitoring

A major innovation in 2007 has been the development of the School Census. This will provide NDOE with much more accurate and complete data with which to inform their policies in the future, especially in tracking the move towards UPE. The 2007 census has been successful in eliciting responses and will be repeated again in 2008 as part of an annual cycle.

The major items in the 2008 Development Budget specific to this expenditure priority area are shown below.

**Table 62: 2008 Development Expenditure on Basic Education
(Kina Millions)**

	2008 GoPNG	2008 Donor	2008 Total
Education Training and Human Resource Development Program	1.0	73.4	74.4
Education Capacity Building	2.0	49.2	51.2
Basic Education Development Project (BEDP)	6.0	24.6	30.6
Improvement to Rural Primary Education Facilities (IRPEF)	0.0	4.0	4.0
Other	1.5	11.8	13.3
Total	10.5	161.3	173.5

Source: Department of National Planning and Monitoring

7.2.4 Development Oriented Adult Education

According to the MTDS, Development Oriented Adult Education will address the needs of the 50 per cent of adults who desire to enhance their functional literacy and life skills in order to participate productively in the country's economy. Despite its status as an expenditure priority area, the absence of a clearly defined policy on adult education and the clear delineation of responsibility for which part of Government should coordinate the sector's response has resulted in funding to the sector being markedly lower than for other EPAs. Funding to the sector over the previous five years is illustrated in the table below.

Table 63: Development Expenditure on Development Orientated Adult Education 2003-2008 (Kina Millions)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	2.0	0.0	10.5	8.1	20.6
2004	1.0	0.0	15.3	5.9	22.1
2005	1.0	0.0	6.1	3.7	10.8
2006	1.3	0.0	5.8	6.4	6.4
2007	3.5	0.0	5.1	2.9	11.4
2008	3.3	0.0	0.4	0.0	3.7

Source: Department of National Planning and Monitoring

In recent years, NDOE has focussed efforts on promoting technical and vocational education opportunities for students who drop out of the formal education system, particularly after years 8 or 10. Increasing the viability and attractiveness of alternative education paths is key to broadening the proportion of each age cohort who enters the workforce. In addition, this will reduce pressure on the traditional education system whose limited capacity cannot cater for all children and consequently leaves those children who fail to pass each grade disillusioned.

Meanwhile, the Department of Community Development has focussed on expanding functional literacy and initiatives aimed at particular target groups, such as women. Educating women brings a range of different benefits, not least the added contribution to economic growth by enabling their participation in the labour market.

The Government is increasingly looking to churches, NGOs, the private sector and other civil society organisations to deliver services in this sector, consistent with the underlying principle of the MTDS in forging strategic alliances.

The major program in the 2007 Development Budget specific to this EPA are shown in the table below.

Table 64: 2008 Development Expenditure on Development Orientated Adult Education (Kina Millions)

	2008 GoPNG	2008 Donor	2008 Total
Vocational Training Support	2.0	0.0	2.0
Provincial Vocational Centre Capacity Building	1.0	0.0	1.0
Employment Orientated Skills Development Project	0.4	0.0	0.4
Other	0.3	0.0	0.3
Total	3.7	0.0	3.7

Source: Department of National Planning and Monitoring

7.2.5 Transport Rehabilitation and Maintenance

Transport infrastructure plays a vital role in creating and supporting economic growth by facilitating the movement of labour and capital, connecting different components of the supply chain and enabling markets by bringing buyers and sellers together. Transport also plays a key role in social development by enabling service delivery, law and order, education and health services which rely on the efficient movement of goods and people.

Transport infrastructure in all three modes of transport - land, air and water - represents a major and valuable component of Government's assets. However, like many other public assets, such infrastructure has been poorly maintained. Reasons for this include inadequate financing, poor prioritisation, lack of recognition of PNG's fast depreciation rate, poor allocation of responsibilities between different tiers of Government and the absence of effective mechanisms to manage the state of assets. To this end, the MTDS 2005-2010 places transport infrastructure maintenance and rehabilitation as the priority of Government.

Annual budgetary allocations to transport rehabilitation and maintenance have reflected the priority status conferred in the MTDS. Total resources to the sector in the annual Development Budget have increased significantly year on year and now represent more than half a billion kina annually. This does not include the substantial additional financing made possible through the Supplementary Budgets. With two thirds of total funding to this EPA originating from Government sources (either in direct financing, tax credit scheme or loans) this remains one priority area where Government is clearly seen to be driving its development agenda, rather than allowing its development partners to take the reins.

Table 65: Development Expenditure on Transport Maintenance and Rehabilitation 2003-2008 (Kina Millions)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	93.5	0.0	137.5	147.6	378.7
2004	89.4	0.0	115.0	240.8	445.3
2005	105.6	69.2	137.5	211.5	523.9
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	558.8

Source: Department of National Planning and Monitoring

Efforts to maintain and rehabilitate transport infrastructure to good and usable conditions is materialising, as evidenced by the annual assessment of the 8,521km national road network under the Road Assets Management System, through which each 10km stretch of road is classified as good, fair or poor. The standard of national roads has improved markedly, with the share judged to be in good condition increasing from 10 per cent to 20 per cent in just four years (2003-2006). It is envisaged that the proportion of national roads in good condition will increase further as the high level of funding towards this sector is sustained and allowing for the lag between appropriations, the letting of contracts and the completion of works.

CAA's efforts to lift PNG's 22 regional airports to a minimum safety standard are also underway, made possible by funding through the Supplementary Budget. At the beginning of 2007, two airports had received their certificate and a further four are expected to meet the requisite standard by the start of 2008. In addition, negotiations are underway for a US\$100m loan from the Asian Development Bank to finance the extension of the port at Lae, which is responsible for trafficking some 80 per cent of PNG's exported goods.

However, a number of constraints remain. The increasing volume of maintenance and rehabilitation contracts has put pressure on both the public and private sector's capacity. These capacity weaknesses extend to the Tenders Boards, particularly those at provincial level. There remains some uncertainty over Government's intention to complete the institutional reform that saw the establishment of the National Roads Authority. Government needs to make adequate provisions to provide routine maintenance on all infrastructure which is in good condition and has recently been rehabilitated.

In addition, the prioritisation of rehabilitation and maintenance works still needs to be improved, given the large volume of funding to the sector and the variety of needs to which these finances can be directed. The National Transport Development Plan 2006-2010, the sector's strategic approach for the medium term, explicitly aims to prioritise and focus investments on transport infrastructure assets which are deemed to be of significant economic and social importance. This includes the 16 priority national roads that together represent the backbone of PNG's transport infrastructure network: the Highlands Highway, Buluminisky Highway, Koroba-Mendi Road, Pogera-Togoba Road, New Britain Highway, Sepik Highway, West Coast Road, Baiyer Road, Hiritano Highway, Coastal Highway, Kokoda Road, Wau Road, Buka Road, Magi Highway, Ramu Highway and the Northern Road. At present, while significant appropriations are made for transport rehabilitation and maintenance, once allowance is made for sea and air transport and for provincial roads, the share that remains for national roads is remarkably small. Given the cost of carrying out major rehabilitation and reconstruction works, the balance of funding within transport will need to be changed if Government is to accelerate the pace at which the national road network is revitalised.

The major items in the 2008 Development Budget specific to this expenditure priority area are shown below.

Table 66: 2008 Development Expenditure on Transport Maintenance and Rehabilitation (Kina Millions)

	2008 GoPNG	2008 Donor	2008 Total
ADB Road Maintenance & Upgrading Project (5 Highlands Provinces)	97.7	0.0	97.7
PNG Transport Sector Support Program	1.0	92.2	93.2
Performance Grant	0.0	73.9	73.9
Tax Credits & TCS Administration	73.7	0.0	73.7
World Bank Road Maintenance Project	69.6	0.0	69.6
National Road Maintenance Program	30.0	0.0	30.0
Key Roads For Growth (KRFG)	1.5	20.1	21.6
Bridge Maintenance Program	15.0	0.0	15.0
Construction Machinery & Workshop Facilities	0.0	14.3	14.3
Other	49.5	20.3	69.8
Total	338.1	220.8	558.8

Source: Department of National Planning and Monitoring

7.2.6 Promotion of Income Earning Opportunities

The Promotion of Income Earning Opportunities in the MTDS is a response to the low productivity of labour in PNG and the limited options available to individuals who wish to participate in the economy. This is one of the underlying factors contributing to the low standard of living as portrayed by PNG's socio-economic indicators and the ongoing problems with law and order, particularly in PNG's major urban centres of Port Moresby, Lae and Hagen.

Enhancing access to income earning opportunities is inseparably linked with tackling the major impediments to business in Papua New Guinea. In addition, promoting labour intensive industries in which PNG has a comparative advantage, can help address these problems. Furthermore, broadening access to income generating opportunities is consistent with Papua New Guinea's principles of facilitating individual responsibility through investing sweat equity.

In recent years, the level of formal employment has begun to increase. PNG's employment index rose from 111.7 in the June quarter of 2005 to 120.4 in the June quarter of 2006, before jumping markedly in the June quarter of 2007 to 131.9. This increase has been spread fairly equitably across the country, though the biggest increases are attributable to the Momase and Islands region. The key sectors contributing to the increase in formal employment are retail, building and construction, agriculture, forestry, and fisheries. Government's large investments in rehabilitating public infrastructure have undoubtedly played a significant part in this growth, with the provision of major contracts focussed largely on roads and buildings. Given the lag in issuing these contracts and the spreading of appropriations over longer time periods through the operation of trust accounts, this trend should continue further in the coming years.

While this news is welcome, the large majority of Papua New Guineans are dependent on informal jobs to generate incomes. Assuming there has been little change in the share of PNG's economy which is formal, one can infer that the strong performance of the formal labour market is mirrored in the informal sector, since most informal jobs directly or indirectly serve formal businesses and their employees.

Disciplined and consistent Government policy has played a vital role in delivering an improved investment climate in recent years. PNG's macroeconomy continues to perform well, with debt reducing and the Government running budget surpluses, enabling both inflation and interest rates to be kept low. This stability was maintained through the election period, in stark contrast to the past when the political cycle impinged on Government policy and the business cycle. In addition, the election took place under relative calm, in contrast to some expectations. PNG's recently improved credit rating is testament to this performance.

Recent changes to PNG's taxes are also intended to promote business and employment. These include the green revolution tax incentives, the concessions to investment in tourism and the reduction in tax on Zoom, relied upon by PNG's islands communities and fishing industry.

Government's investment in transport infrastructure will have a direct impact on business operating costs and profitability. However, the quality of service provision for other utilities remains poor, particularly for power, forcing many businesses to purchase diesel generators which are costly to purchase, maintain and operate. The arrival of Digicel in the mobile phone market has had an immediate impact in reducing the cost of telecommunications.

Table 67 summarises the level of investment to this EPA over the past 5 years:

Table 67: Development Expenditure on Promotion of Income Earning Opportunities 2003-2008 (Kina Millions)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	26.8	0.0	59.6	133.6	220.0
2004	22.6	0.0	38.5	71.8	132.9
2005	48.2	18.7	32.5	67.5	166.8
2006	49.2	0.0	10.8	85.9	85.9
2007	51.5	0.0	8.2	67.9	127.6
2008	38.4	0.0	17.0	141.4	196.9

Source: Department of National Planning and Monitoring

Government, together with support from its development partners, continues to balance its support across traditional sectors, such as mining; potential downstream sectors such as in forestry, gas and fisheries, which promise employment and retain value-adding activities within PNG; and the country's emerging renewable sectors, such as tourism. Its 2008 investments, as detailed in the table below, mirror this support.

Table 68: 2008 Development Expenditure on Promotion of Income Earning Opportunities (Kina Millions)

	2008 GoPNG	2008 Donor	2008 Total
Mining Sector Support Program	0.0	37.1	37.1
PNG Incentive Fund	0.0	24.6	24.6
Rural Economic Development	0.0	20.0	20.0
Microfinance and Employment	14.9	0.0	14.9
PNG-Australia Agriculture Research and Development	0.0	14.8	14.8
Smallholders Agriculture Development Project	6.0	0.0	6.0
Other	34.6	44.9	79.5
Total	55.5	141.4	196.9

Source: Department of National Planning and Monitoring

7.2.7 Law and Justice

Papua New Guinea has the tough challenge to address crime and corruption in all its forms, as articulated clearly in the MTDS. The present law and order situation in the country has been commonly related to the rapid and widespread socio-cultural transition that has taken place across the country. The types and occurrences of crime vary across communities from violent crimes to violence against women, tribal fights, land disputes, and the increasing incidences of fraud and corruption. The law and order situation has proven to be one of the major hindrances to private sector led economic growth, whilst also affecting quality of life in both rural and urban communities. In a well functioning market economy, peace and good order and a fair and effective justice system is an important precondition to encourage savings, investments and accumulation of goods and services that would lead to higher living standards.

The sector coordinated approach of the Papua New Guinea Law and Justice Sector Strategic Framework was endorsed in 2005 with the vision, "A Just, Safe and Secure Society for All". This framework provides an integrated system through which efforts are coordinated to ensure the appropriate distribution of resources and a unified effort in trying to improve the law and order situation. The framework also guides planning and budgeting for the sector. The Law and Justice Sector also seeks to encourage the involvement of the community in addressing crime. Progress is measured through regular and systematic monitoring of Key Performance Indicators which together comprise a Performance Monitoring Framework.

This approach to organising Government and other stakeholder interventions has enabled the sector to be highly productive in pursuing its goals.

In 2007, the sector's Media Office ran a campaign highlighting sector success stories, to bring attention to the work of the sector and successful approaches to bringing about change. Efforts have also focussed this year on bringing the work of NGOs closer to Government, informing them of the role of different Government agencies involved in the sector and providing new opportunities for cooperation.

The new White Paper on Law and Justice, launched in March 2007, has major implications for the administration of the sector, including the need for imminent institutional reform. This will include the establishment of a new Government Law Office under the Attorney General. This will house both the Office of the Solicitor General and the Office of the State Solicitor. Alongside the new Government Law Office will sit the Department of Justice. Meanwhile, the semi-autonomy of the Public Prosecutor and Public Solicitor will be reaffirmed by their being housed outside these two institutions, as separate offices.

For courts to remain effective, they must be capable of bringing cases to their conclusion within a reasonable timeframe. Attention has been brought to the capacity of both Supreme and National courts to handle their case loads. Low completion rates imply long court cases and consequently higher costs for the sector, e.g., judges' costs and holding prisoners on remand. The low completion rates of Supreme Courts can be partly explained by their being occupied with sundry tasks, such as petitions and other tribunals.

Two major pieces of reform respond directly to this issue. The first is Government's approach to Indictable Case Management. The Sector is developing a tracking process for all criminal and civil cases, which will ultimately enable more effective management of cases by the different sector agencies, honing attention on the need to bring all cases to their completion in a timely manner. Another area of reform has been a review of minor cases. The Sector's aim here is to ensure that cases are treated at the appropriate level, so that the country's high-level courts are not burdened with cases that could be handled equally effectively by lower level courts.

Government funding to the sector, through the development budget, has increased markedly in recent years – see the table below. This has enabled greater Government leadership in a sector, which in the past was strongly reliant on GoPNG's development partners. The large appropriation of funds under the recent Supplementary Budgets for infrastructure rehabilitation will support efforts already underway to improve the standard of infrastructure important to service delivery. Existing initiatives include the upgrade of a number of prisons, including Baisu prison in Western Highlands and Biru women's prison in Oro. In addition, initial works have begun in preparation of the major reconstruction of the Madang Court. This project intends to unite all court services under a single roof and, if successful, will serve as a model to the rebuilding of courts in other provinces.

Table 69: Development Expenditure on Law and Justice 2003 – 2008
(Kina Millions)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	4.0	0.0	0.0	56.9	60.8
2004	0.8	0.0	0.0	73.3	74.1
2005	13.5	10.0	0.0	510.3	533.8
2006	26.8	0.0	0.0	76.6	76.6
2007	30.5	0.0	0.0	96.0	126.5
2008	31.0	0.0	0.0	108.3	139.3

Source: Department of National Planning and Monitoring

The major projects for this EPA in the 2008 Development Budget are identified in table 70.

**Table 70: 2008 Development Expenditure on Law and Justice
(Kina Millions)**

	2008 GoPNG	2008 Donor	2008 Total
Law and Justice Sector Programme	31.0	67.2	98.2
Law and Justice Initiative (ECP)	0.0	17.2	17.2
Border Management & Transport Security (ECP)	0.0	12.3	12.3
Justice Advisory Group (JAG)	0.0	6.0	6.0
Community Policing	0.0	4.4	4.4
Other	0.0	1.1	1.1
Total	31.0	108.3	139.3

Source: Department of National Planning and Monitoring

2009 will see the beginning of the second phase of the Law and Justice Sector program and work has already begun on its preparation. Though the program will naturally build on the elements of the earlier phase, changes in emphasis will include a shift to a greater provisional focus, both for decision-making and service delivery, and on expanding the already strong focus on performance monitoring.

7.3 ECONOMIC SECTORS

7.3.1 Agriculture

Agriculture plays a significant role in realising the broad-based development strategy articulated in the MTDS, providing income and employment opportunities for 87 per cent of the Papua New Guinea population. The challenge remains as to how the significant potential of the sector can be harnessed, thereby increasing its contribution towards the 5 per cent GDP growth targeted in the MTDS and in doing so, reducing poverty and enhancing the quality of life of the rural majority.

With the majority of the country's population living in the rural areas, increasing population growth places a growing burden on the agricultural production systems. The need to address this and other related impediments faced by the agriculture sector requires a much improved, holistic approach to planning, budgeting, coordination and implementation in the sector. The decentralisation of functions and powers under the Organic Law on Provincial and Local Level Governments and the policy shift to allow corporatization of agricultural commodity bodies has led to disjointed planning and coordination in the sector. Failure to address the impediments facing the sector has resulted in stagnation and fragmentation of the sector.

Indeed, performance by PNG's major agricultural export crops of copra, cocoa, coffee, palm oil, rubber, tea and copra oil has been mixed in the last 5 years (2000-2006). Copra and coffee which used to be the lead export crops have performed poorly during this period while oil palm is the biggest success story, with exports now at 381,000 tonnes a year, a steady increase from only 309,000 in 2001. Copra oil and cocoa performed well beside rubber.

The Government launched the National Agriculture Development Plan (NADP) 2007-2012 early in 2007. This Plan is both ambitious and broad, with the vision of having Government overcome various obstacles to the sector, thereby unleashing private sector growth. Key areas for intervention include research and technical services (extension and information); food and horticulture; tree and industrial crops; livestock; apiculture and aquaculture; spices; and the strengthening of NADP management.

One of the interventions heavily promoted in the NADP is the nucleus estate concept in major agricultural commodities, based on lessons learnt from the oil palm sector. In addition, the Plan intends to develop a credible monitoring framework with measurable indicators that will be used to assess performance against targets set within the framework.

With expectations of persistently high investments, further work will have to be carried out to determine the most effective way of prioritising and sequencing interventions in the sector where Government money can be effective. This extends to the K80 million of appropriations made in recent Supplementary Budgets.

One of the policy initiatives through which Government has attempted to stimulate the agriculture sector is through the package of tax incentives that make up the Green Revolution. Initiated in 2004, the Green Revolution initiative includes a 150 per cent tax deduction in agricultural research and development (R&D); a 150 per cent deduction for agriculture extension services; and a 20 per cent income tax rate for new agricultural projects. The industry's response to this initiative has been positive as evidenced by the 13 applications for the R&D exemption received by Government up to 2006, each representing an investment in excess of K30m. The National Development Bank also encourages investment in the sector, through the provision of its loans.

The Government accepts that efficiency gains can be realised through scaled-up coordination and collaboration amongst key stakeholders within the sector, particularly between the National Department of Agriculture and Livestock and the commodity and agricultural research organisations, the provincial divisions of primary industries, development partners and the private sector participants. Increased establishments of agriculture-based Cooperative Societies may also contribute towards this end.

One of the most significant interventions by Government to complement the major investments in the agriculture sector is the tremendous investment in transport infrastructure maintenance over recent years. Improvements attained in the quality of transport infrastructure should translate into better access to markets and improved delivery of agriculture goods and services, especially to rural farming communities.

7.3.2 Fisheries

Papua New Guinea is blessed with abundant marine resources. The country's fisheries zone of 2.4 million square kilometres is the largest in the Pacific. PNG's fisheries sector is not only focused on marine resources but also on inland aquaculture resources such as trout farming.

Fisheries is a key sector for achieving economic growth as outlined in the MTDS 2005-2010. As a sector capable of providing a renewable source of economic and social benefits the fisheries sector is at the core of Government's plans. The government is promoting and developing this new emerging economic sector to gradually take on the responsibility and revenue stream that is currently being provided through the mining and petroleum sector. While fisheries provide a huge opportunity for the country, particularly in terms of employment, it also presents enormous challenge for monitoring and control.

According to official records, the quantity of marine products exported from PNG was 17,300 metric tonnes in 2006 indicating zero growth since 2001. Nevertheless, this represents a marginal improvement from 2005 (15,700 metric tonnes). There is capacity to increase the volume of catch to 100,000-150,000 tonnes per year.

Currently, a wide range of players are involved in the fishing industry in PNG. At the international level, PNG has access agreements with Taiwan, Korea, Philippines and China which are negotiated on an annual basis.

The strategic area for development is the establishment of more downstream processing of catch in the country. Integrating fishing, processing and marketing returns the greatest benefit to the economy. PNG is fortunate to have three private companies operating onshore tuna processing facilities: RD Tuna Cannery (Madang), South Seas Tuna Corporation (Wewak) and Frabelle (Lae). While RD Tuna Cannery's business activity is currently focused solely on tuna canning, South Seas Tuna Corporation produces tuna loins. Frabelle produces both tuna loins and canning. These companies create much needed jobs. Currently, RD Tuna Cannery employs the highest number of people (2,500) followed by South Seas (1,645) and finally Frabelle (800). RD Tuna have plans to expand their capacity later this year, before venturing into other products (including loining) from 2008 onwards.

The potential to expand downstreaming in PNG is evident from the large number of purse seine vessels licensed to fish in PNG waters which at present never land at PNG's ports. Of 186 licensed boats, only 34 have their catches processed in PNG and of these, only 7 are owned by PNG companies.

The Madang Marine Park is a major economic impact project intended to attract more downstreaming in PNG. It involves the development of major infrastructure facilities intended to leverage economies of scale and agglomeration, job creation and reduction of post harvest losses. Progress on the implementation of this project has however been slow and is limited to the registering of the vehicle company "Madang Marine Park Holdings Limited" with the IPA, site feasibility and investigation, and land valuation. The next steps are for the principal lead agencies, ICDC, NFA and DCI to clearly state and indicate the project work program and its budget.

The Government and its development partners are co-funding several other smaller projects including the Wewak fish market and jetty funded by JICA and the fisheries development assistance project for Pacific Island Nations which is initially being implemented by the National Fisheries College and Kokopo fish market.

Other key areas the sector is focusing on include: improved market access for fishery and marine products; improved marine product quality; improved research, development and dissemination of information; improved and easy access to credit by fishermen; and building institutional capacity at the provincial and lower levels to improve coastal fisheries management. This year's reduction in tax on Zoom – with a special excise rate of 30t per litre – will contribute significantly to the viability of individual fishermen and small fishing enterprises.

PNG is also in the process of negotiating the Economic Partnership Agreement with the EU. Negotiations are officially scheduled to come to a conclusion by December 2007. The main objective of the Agreement is to obtain better market access for key PNG's export products – principally marine products – to the European single market.

In addition to the major industry players, many other small fishing businesses operate within the country. At the subsistence level marine resources are a very important source of diet for communities around the coastal areas.

7.3.3 Forestry

A key pillar of the MTDS is the Government's pledge to encourage and empower Papua New Guineans to fully utilize their resources for income generation. As host to the world's second largest tropical rainforest, this policy applies to Papua New Guinea's forestry sector.

At present, PNG's forestry sector is dominated by logging. PNG's largest export species are taun, malas and calophyllum, with West New Britain, East New Britain, Western and Gulf representing the highest exporting provinces. The exports of PNG round logs has increased from 1.4 million cubic meters in 2001 to 2.5 million cubic meters in 2006, the latter valued at K489 million. Based on data from the first quarter of 2007 and progress on the Government's ten major forestry projects, this upward trend is set to continue further. As well as providing significant tax earnings to Government, royalties and levies to landowners are currently estimated at around K30-40 million a year.

At present, the National Forestry Authority has signed eight of the ten major impact projects envisaged in the MTDS. Five of these are already operational: Amanab 1-4 (Sandaun), Asengseng (WNB), Rottok Bay (WNB), Cloudy Bay (Central) and East Awin (Western Province). Three have works pending: Amanab 5-6 (Sandaun), Aitape Lumi (Sandaun) and Middle Ramu Block 1 (Madang). East Pangia (SHP) is undergoing project evaluation and selection while Kumulu Doso (Western) is currently before the National Court.

As part of the revised tax regime since 2007, timber permit, timber authority and timber licence holders are now required to pay a new levy called "premium levy" of K8 per cubic metre in respect of the exports of natural unprocessed logs. The levy is being administered using similar arrangements as currently applied for development levies paid in petroleum projects. The government has offset the cost to the industry of paying this levy by reducing the log export tax. At the same time the log export tax was changed to a flat rate for the purpose of simplification.

The Government is mindful that to maximise the returns from the forestry sector it must improve governance, enforce sustainable practices including diversification of forest-related investments, eradicate illegal logging, eliminate corruption and effectively administer landownership issues, including management of landowner expectations.

SGS monitor the export of logs from PNG, verifying the accuracy of data reported to Government from logging companies. Inaccurate reporting is a form of tax evasion. Each year, more than 50 per cent of ships inspected are found to have reported their shipments inaccurately. Meanwhile, anecdotal evidence suggests that monitoring of log exports is improving compliance to global and local industry standards. The Government will continue to examine ways to improve compliance in this sector, including the possibility of giving the monitoring agency greater powers to punish malpractice and incentivise best practice in the sector.

Diversifying from logging to other forestry-related activities such as reserves and eco-tourism will further increase the economic returns from the industry and also promote sustainability of the sector. Reforestation and plantation which render the sector sustainable remain undeveloped in PNG. Downstream processing activities such as sawmills, furniture, flooring and mouldings have the potential to grow and the latest venture in Central Province is evidence of this.

The Government continues to explore opportunities that will create incentives for the protection of PNG's forests. The incorporation of natural rainforests under the Kyoto Protocol's carbon trading mechanism remains a global agenda of Government. PNG has established itself as a key advocate in this movement at the global level. The proposed establishment of a National Clean Development Mechanism Authority to prepare PNG for such ventures remains on the Government's agenda.

7.3.4 Tourism

Papua New Guinea's tourism sector has major potential to contribute to the country's economic growth and prosperity, as identified in the MTDS. Unlike many of PNG's key economic sectors, tourism has the potential to be sustainable, if well managed and to create significant employment, including among the low skilled.

The Tourism Master Plan 2007-2017, with the theme “Growing Tourism as a Sustainable Industry” was launched early in 2007. The overall goal of the Master Plan is to “increase the overall economic value of tourism to the nation by doubling the number of tourists on holiday in Papua New Guinea every five-years and maximizing sustainable tourism growth for the social and environmental benefit for all Papua New Guineans”. This target can be achieved by fostering PNG’s reputation – through effective marketing - as a niche tourism location, focussed on diving, surfing, trekking, bird watching and cultural shows. In addition, efforts are required to overcome some of the major obstacles to tourism, most notably the cost of travel and PNG’s reputation for poor law and order.

Official tourist figures have increased steadily from 13,800 in 2001 to just under 23,000 in 2006. If numbers continue to rise at the current rate, the Master Plan target may be achievable. Concerns have nevertheless been raised regarding the number of business people and migrants who falsely claim to be tourists for ease of access into PNG.

A key recommendation of the Master Plan is the separation of the policy and marketing functions of the TPA. This is to be achieved through the replacement of the existing TPA with a new industry-driven body to oversee and coordinate destination marketing, called ‘Tourism PNG’. In addition, a Tourism Policy Secretariat is recommended to be established under the Ministry of Culture and Tourism to handle all policy matters. Progress on these institutional reforms since the launch of the Master Plan has stalled.

The tourism sector is now benefiting from a major overhaul of the Government’s tax incentives to the sector, which have seen PNG’s tax package falling closer in line with those of rival country destinations. The tax concessions include exemption from GST for the purchase of travel tickets and accommodation for foreigners making their bookings prior to their arrival; increased accelerated depreciation; and double deduction on staff training. Further tax breaks are made available for the construction of new tourist accommodation facilities, including the extension of the tax credit scheme to the sector.

Since 2007, the National Development Bank has been used to manage the provision of loans to small and medium sized tourism businesses. This role is expected to expand over the coming years.

Major events in 2007 include the hosting of the Tourism Expo in Port Moresby and the conducting of a tourism roadshow to a series of Australian tourism operators in August to promote PNG as a destination.

7.3.5 Oil and Gas

Since 1990, the oil and gas sector has played a key role in Papua New Guinea’s development. In recent years the sector has contributed an average of 10 per cent of the country’s GDP and 25 per cent of its export earnings.

As a complement to the established oil sector, the MTDS recognises the need to support gas commercialisation. Moreover, gas has the potential to become Papua New Guinea’s most valuable natural resource.

PNG’s oil production is currently at 40,000-45,000 barrels per day. This production comes from Kutubu, Gobe, and Moran oil projects. Oil production is dwindling due to a natural decline in the producing fields. Unless new discoveries are made and/or more appraisal wells are drilled within mature fields identifying new pockets of oil, current oil fields will not sustain production for long.

To arrest this fast decline in oil production, the Government is committed to actively pursue a Gas Commercialisation Strategy. This targets the following developments:

- The development of a Liquefied Natural Gas (LNG) industry;
- The development of a gas-based petrochemical industry;
- The development of a gas-fired rural electrification program; and

- The promotion of an energy-intensive minerals processing industry, such as aluminium smelting.

Since the abandonment of the PNG Gas to Queensland Pipeline Project in 2006, the newly elected PNG Government is vigorously pursuing the development of a LNG project. The development of a LNG plant represents the biggest commercial investment project in PNG's history to diversify the country's export portfolio. Therefore, the Government remains committed to actively participating in the commercial development of PNG's significant gas reserves. The K500 million that was set aside to purchase a substantial part of Papua New Guinea's equity stake in the PNG to Australia Gas Project will be used to purchase its stake in the LNG project. To add to this, the 2008 Budget has appropriated an additional K100m for State equity in gas commercialisation, together with K50m for infrastructure at Konebada Petroleum Park.

To date, a number of LNG project proposals have been submitted to Government, including those from Liquid Niugini Gas Limited (comprising InterOil, Merrill Lynch and Pacific LNG) and Exxon Mobil; and the Oil Search Limited.

Preliminary negotiations are ongoing between the Government and Exxon Mobil on a draft Project agreement. The Exxon Mobil LNG project will involve capital investment worth US\$10-12bn. It is expected that the project will be designed to export about 6.3m tons per annum of LNG. The decision to enter into FEED (Front-End Engineering and Design) studies is expected to be made by December 2007 or early 2008. The Joint Ventures are currently working on a Co-operative Development and Operating Agreement that will define the relationship of the different partners in relation to the LNG project for its full economic life. This agreement is scheduled to be signed before the end of 2007.

The Liquid Niugini Gas Limited draft project agreement focuses on a different set of gasfields. Information on the confirmed gas reserves in the project area will determine the outcome of this proposal.

In addition to the substantial direct benefits that will be generated through an LNG project is the establishment of backbone infrastructure that will help underwrite investment in other gas commercialisation opportunities, such as the development of a petrochemical industry at the Konebada Petroleum Park. A number of international companies have expressed their interests to the Government in various gas-based industries which would follow the establishment of the first LNG project. These include the following:

- *DME/Methanol project:* This project is being pursued by two Japanese energy companies namely, Itochu and Mitsubishi Gas Chemicals and would involve the indirect purchase of gas at a marine export location. The project's value is estimated to be worth around US\$800m and would require approximately 2 TCF of gas. The commissioning of this project is targeted for 2010.
- *Urea/fertilizer plant:* A Memorandum of Understanding has been signed between Oil Search and a Perth-based Indian company, Oswald to advance the development of a fertilizer plant. As with the DME/Methanol project, Oil Search Limited will be the supplier of feed gas for this proposed fertilizer plant.

The up-turn in petroleum exploration activity resulting from fiscal incentives introduced in 2003 is continuing. 21 new Petroleum Prospecting Licences (PPLs) have been issued over the past four years bringing the total number of PPLs to 36. There has been a significant increase in the number of new applications for PPLs. The Department of Petroleum is currently reviewing nine new applications for PPLs from various companies.

7.3.6 Mining

The mining sector continues to be promoted as a major export revenue earner for Papua New Guinea since 1973. The sector is responsible for over 50 per cent of Papua New Guinea's export revenue.

The country hosts a number of world-class mining operations and remains highly prospective in mineral deposits. The Government's attractive policy and fiscal incentives combined with the current high mineral prices provide PNG with the opportunity to continuously increase exploration for future mining development, as well as fast track the process of commencing new mining operations. The recent rapid increase in exploration activities demonstrates that PNG continues to have the potential to attract new investors into the mineral sector. This is evidenced by the large number of Exploration Licences (ELs) applications received by Government, totalling 131 in 2006 and a further 42 in 2007 to date. 7 ELs were ultimately granted in 2006 compared to 28 ELs to date for 2007. Additional tenement portfolios include 5 mining leases, 140 small-scale alluvial mining leases and 6 special mining leases.

There are 13 advanced exploration projects that are nearing pre-feasibility or feasibility stages. These projects are: Frieda copper, Wafi copper/gold, Yandera copper, Mt Kare gold, Woodlark gold, Imauna gold, Sehulea gold, Wapolu gold, Esalla gold, Wowo Gap nickel/cobalt, Mt Nakru copper/gold, Simuku copper/gold, and the Solwara copper/gold/silver project.

In addition, there are significant drilling programs currently underway where exploration licences have been granted. These include: Frieda, Woodlark, Wowo Gap, Wafi, Hidden Valley, Lihir, Ok Tedi, Feni, Tolukuma, Mt. Kare, Yandera, Wapolu, Gameta, Weioko, Sehulea, Mt. Bini, Mt. Nakru, Mt Penck and Simuku. Some advanced projects are indicating commitment to begin production such as Yandera in the year 2011.

PNG created history in 1999 when the government issued the world's first offshore Exploration Licence to Nautilus Minerals to explore for gold, copper and silver in the Bismarck Sea at depths in excess of 1,000 metres. Following trial mining, Nautilus is investigating the possibility of utilising a specialised ship for the purpose of conducting operations, complete with remotely operated robotics. A commercial cutter suction dredge would mine sulphide chimneys 1.6km below sea level at a rate of 1.8 million tonnes annually, making it a world first by late 2009. The ore averages 8 per cent copper and 7-8gpt gold. Nautilus has previously projected annual production of 500,000 ounces of gold and 160,000t of copper. The company has projected an initial production rate of 1 million tonnes per annum with the capacity to double throughput to 2Mtpa. The Government views this as an exciting new mining development as it represents the world's first ever sub-sea mining of a sulphide mineral.

It is estimated that approximately 60,000 people are engaged in largely informal, but legal, small-scale mining (SSM) in PNG, predominantly for gold. The majority of alluvial miners, comprising about 90 per cent of the sector use pans, shovels, rudimentary sluices and shaking boxes and occasionally small water pumps. The main alluvial mining districts are Wau/Bulolo (Morobe), Mt. Kare & Porgera (Enga), Yodda (Oro) and Maprik (ESP). However, alluvial and placer gold is found almost everywhere in Papua New Guinea. The total output of the sector is difficult to quantify. According to estimates by Metals Refining Operations Ltd, only about 70 per cent of the alluvial gold is sold to commercial gold buyers for refining and export. The remaining 30 per cent is sold and exported illegally. In this case, the 1.9 tonnes of legally refined gold from SSM points towards a total yearly output of some 4-5 tonnes. This represents K180 million annually. For the SSM miners, average earnings are estimated at 250 Kina/month.

Recent developments have seen the industry diversify with the extraction of nickel and cobalt at Ramu by the Metallurgical Chinese Corporation. It is expected that the Ramu project will produce about 33,000 tonnes of nickel and 3,300 tonnes of cobalt for 20-plus years, commencing 2009. Latest additions to the existing operating mines are Simberi, Sinivit and Hidden Valley gold mines.

Simberi is expected to produce 60,000 ounces of gold per year for 10 years from 2007. Similarly, Sinivit is expected to produce 50,000 ounces of gold per year for between 2-5 years from 2007. The Hidden Valley project will produce 310,000 ounces of gold per year for between 7-10 years from 2009.

Despite positive developments in the sector, key challenges remain which the Government must continue to address. These include:

- The full realisation of the Mineral Resource Authority to effectively facilitate, coordinate and monitor the developments of existing and new mines;
- The need to fulfil Government's obligations under the existing mining projects' Memoranda of Agreement;
- The continuing shortfall in skilled manpower; and
- Rising costs affecting the industry, especially petroleum products

7.3.7 Manufacturing

The Government seeks to increase the value of exports produced by Papua New Guinea's manufacturing sector, focusing on the downstream processing of raw materials originating from Papua New Guinea's extractive industries. The strategy for increased industrialisation is to remain commercially driven and to target Papua New Guinea's areas of current and emerging competitive strength. Furthermore, it has the potential to contribute significantly to PNG's formal employment growth.

There has been a small but positive trend in the contribution of the manufacturing sector to real GDP growth in recent years. More marked has been the significant rise in formal employment from this sector, with the sector's employment index climbing to 136.8 from the 2002 base year (100). Much of this increase can be attributed to the full operation of the InterOil Refinery since 2004 and the expansion in the tuna processing industry in developing product varieties in response to an increase in domestic and international demand.

A number of major initiatives in the sector are expected to further promote growth and its contribution to the economy in terms of employment and tax revenue to the Government in the medium term. These include the development of a LNG processing and exporting plant of which negotiations between the State and potential developers has commenced in 2007 and the associated development of a petrochemical industry as a key component of the Gas Commercialisation Strategy; the growth in down-streaming in both fisheries and forestry; and the potential development of downstream activities in the palm oil and cassava industries to generate biofuels. There is domestic demand for some of these products, particularly in biofuels.

The Government is playing a proactive role to create an enabling environment that will allow local industry to take maximum advantage of new opportunities as they emerge in the global market, as well as the promotion of foreign investment which can provide both jobs and new sources of tax revenue. Traditionally this environment was largely created through direct fiscal concessions. However, studies have shown that this has done little to encourage investment, as specific structural and regulatory settings have outweighed these incentives. To this end, the Government has made Law and Order and Transport Maintenance and Rehabilitation priorities, areas which, if addressed, should provide the enabling environment for business. Moreover the work by the Government's National Technical Working Committee on Removing Impediments to Business and Investment since 2005 is intended to untangle issues from import/export monitoring and work permits and visas. The removal of these impediments would encourage the entry of new investments.

Meanwhile, with the ending of the final stage of the current tariff reduction program in January 2006, an independent consultant, Professor Robert Scollay, was commissioned to conduct a preliminary study with the business community and other stakeholders to determine the future of Papua New Guinea's tariff policy.

This assignment was completed in the first half of 2007 and an advisory report is currently under consideration by the Government. Tariff reduction is beneficial for PNG's manufacturing sector in PNG which depends heavily on imported inputs for production.

CHAPTER 8. MEDIUM TERM ECONOMIC & FISCAL OUTLOOK

8.1 OVERVIEW

Papua New Guinea's economy is expected to experience its strongest real economic growth in over a decade with GDP increasing by 6.6 per cent in 2008, underpinned by sustained strong global growth and robust domestic conditions. This vastly improved growth performance is more than twice population growth and represents a significant improvement in average per capita GDP and hence living standards of Papua New Guineans.

The International Monetary Fund (IMF) expects global economic growth to remain well above trend in 2008, reflecting very strong economic growth in emerging and developing countries, particularly China and India and moderate trend growth in advanced economies. Concerns were raised about international inflation in the beginning of last year but since then, pressures have moderated somewhat, dampened by monetary policy tightening. More recently, oil markets point to continued strong growth in demand, and there are continued high prices for major mineral commodities.

In PNG's economy employment in the formal sector has been very strong virtually across all sectors. Stronger growth in output is expected to see a continued increase in employment opportunities and income in PNG over the forecast period.

Inflationary pressures are expected to continue in 2008 with prices rising by 5.2 per cent. This rise in prices largely reflects headline inflation moving more in line with underlying inflation as low food prices experienced in 2007 cease to have a downward impact on the headline rate. While Government expenditure is increasing, particularly on important infrastructure development, prudent management of Government funds and the staggering of actual expenditure should assist to keep inflationary pressures in check over the medium term.

On the external front, the exchange rate will continue to be set by the market in 2008, with the Bank of Papua New Guinea's relatively high level of foreign reserves more than sufficient to perform the role of appropriately managing short-term exchange rate volatility.

Table 71: Principal Economic Forecasts

	2006 Actual	2007 Projection	2008 Projection
Real GDP ^(a)	2.6	6.2	6.6
Real Non-Mining GDP ^(a)	3.7	6.5	6.5
Inflation (Year Average)	2.3	1.8	5.2
Treasury Bill rate	5.0	5.0	6.0
World Economic Growth	5.4	5.2	4.8
Oil Price (US\$ per barrel)	64.3	67.3	61.9
Copper Price (US\$ per pound)	3.05	3.28	2.45

Sources: National Statistical Office, Department of Treasury and IMF

(a) Real GDP and Non-mining GDP for 2006 are Department of Treasury estimates

Over the medium term, the Government will consolidate and improve the macroeconomic performance of the economy by: attracting new investments in the mineral and energy sectors; strengthening the agriculture sector; making the economy more efficient and competitive; and creating an environment conducive for businesses and investment.

The Government has set the foundations for national prosperity using prudent fiscal management, shielding the recurrent budget from the effects of any possible downturn in international commodity prices.

The Government will live within its budget, while retiring debt and other liabilities in order to further improve the Government's financial position and continue to strengthen the private sector. The Government will continue to improve the maintenance of public infrastructure, and will gradually improve service delivery to the people of Papua New Guinea. This is aimed at enhancing confidence and capacity in the economy to promote long-term economic growth.

8.2 WORLD ECONOMIC OUTLOOK 2007 AND 2008

The global economy grew strongly in the first half of 2007, despite recent turbulence in financial markets. However, the turbulence in financial markets has reduced growth prospects in 2008 by almost 0.5 percentage point relative to the April 2007 World Economic Outlook Update. This would still leave global growth at a robust 4.8 per cent, supported by generally sound fundamentals and strong momentum in emerging market economies. The emerging market countries, particularly China and India are the main driving forces of global growth in 2007 and 2008. Overall growth in the emerging and developing countries is expected to be 8.1 per cent in 2007 and 7.4 per cent in 2008. The advanced countries, on the other hand, are expected to grow modestly by 2.5 per cent in 2007 and by 2.2 per cent in 2008.

Risks to the outlook are firmly on the downside, centered on the concern that financial market strains could deepen and trigger a more pronounced global slowdown. Thus, the immediate focus of policymakers is to restore more normal financial market conditions and to facilitate continued growth. Additional risks to the outlook include potential inflation pressures, volatile oil markets, and the impact on emerging markets of strong foreign exchange inflows.

Global inflation in advanced countries is expected to be low at around 2.1 per cent in 2007 and 2 per cent in 2008. For the emerging and developing countries, inflation is expected to be high at 5.9 per cent in 2007 but this should fall to 5.3 per cent in 2008. The declining inflation trend from these countries reflects tighter monetary conditions in the face of concerns about overheating growth and external pressures.

Table 72: IMF World Economic Outlook

	2006 Actual	2007 Projection	2008 Projection
World Economic Growth	5.4	5.2	4.8
<i>Advanced Economies</i>	2.9	2.5	2.2
United States	2.9	1.9	1.9
European Union	2.8	2.5	2.1
Japan	2.2	2.0	1.7
<i>Emerging & Developing Countries</i>	8.1	8.1	7.4
China	11.1	11.5	10
India	9.7	8.9	8.4
Inflation			
Advanced Economies	2.3	2.1	2.0
Emerging & Developing Countries	5.3	5.9	5.3
Interest Rates ¹			
US dollar deposits	5.3	5.2	4.4
Euro deposits	3.1	4.0	4.1
Japan Yen deposits	0.4	0.9	1.1

Source: International Monetary Fund, World Economic Outlook, September 2007

¹ Six-month rate for the United States and Japan. Three-month rate for the euro area.

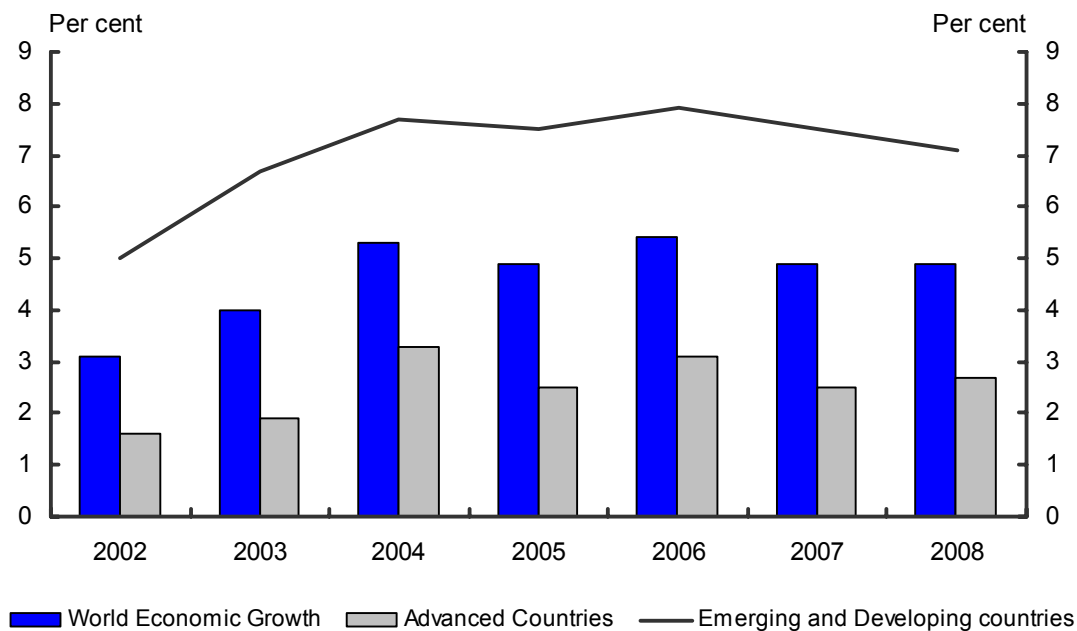
Global financial market conditions have become more volatile. Credit conditions have tightened as increasing concerns about the fallout from strains in the US sub prime mortgage market led to a spike in yields on securities collateralized with such loans as well as other higher-risk securities. Uncertainty about the distribution of losses and rising concerns about counter party risk saw liquidity dry up in segments of the financial markets. Equity markets initially retreated, led by falling valuations of financial institutions, although prices have since recovered and long-term government bonds yields declined as investors looked for safe havens. In the United States interest rates are 5.2 per cent in 2007 similar to 2006 levels but should slightly decline to 4.4 per cent in 2008. In the Euro area, interest rates have increased to 4.0 per cent in 2007 and should slightly increase to 4.1 per cent in 2008. In Japan, interest rates are expected to gradually increase throughout the two years from 0.9 per cent in 2007 to 1.1 per cent in 2008.

8.2.1 World Economic Growth

In the face of turbulent conditions in financial markets, the global economy is projected to grow by 5.2 per cent in 2007 and 4.8 per cent in 2008.

In the face of financial market turmoil, economic growth in the United States is projected to remain at 1.9 per cent in 2008. Ongoing difficulties in the mortgage market are expected to extend the decline in residential investment, while higher energy prices, sluggish job growth and weaker house prices are likely to dampen consumption spending. In the Euro area, growth is projected at 2.1 per cent in 2008, while in Japan growth is projected to be 2 per cent. The emerging market countries, particularly China and India are the main driving forces of global growth in 2007 and 2008. Overall growth in the emerging and developing countries is expected to be 8.1 per cent in 2007 and 7.4 per cent in 2008. The advanced countries, on the other hand, are expected to grow modestly by 2.5 per cent in 2007 and by 2.2 per cent in 2008.

Figure 20: World Economic Growth



Source: IMF World Economic Outlook, September 2007

8.2.2 Inflation

Inflation has been contained in the advanced economies in recent months, but rising food prices have contributed to heightened pressures. In the United States core inflation has gradually subsided to below 2 per cent. In the Euro area, inflation has generally remained below 2 per cent this year. In Japan, prices have been essentially flat. In aggregate, inflation in advanced countries is expected to be 2.1 per cent in 2007 and fall slightly to 2 per cent in 2008.

In the emerging and developing countries, inflation has picked up reflecting strong growth of domestic demand and the greater weight of rising food prices in the consumer price index. Inflation in emerging and developing countries is expected to be high at 5.9 per cent in 2007 but this should fall to 5.3 per cent in 2008.

8.2.3 Commodity Prices

Gold, oil and copper prices have continued to remain high in 2007, after significantly increasing in 2006. The very high gold prices are due to a combination of high investment demand for gold, continued weakness in the US dollar against other major currencies and production reductions of major gold producers. The record high oil prices in late 2007 are due to low oil production of OPEC and the increasing demand for energy by China and India. Two key factors in the rise of copper prices have been increased demand from China and a fall in the copper stock at the London Metals Exchange. Over the medium term, the IMF does not expect the current cyclically high metal prices to be sustained. In particular, this means that oil, copper and gold prices could fall further and more quickly than expected.

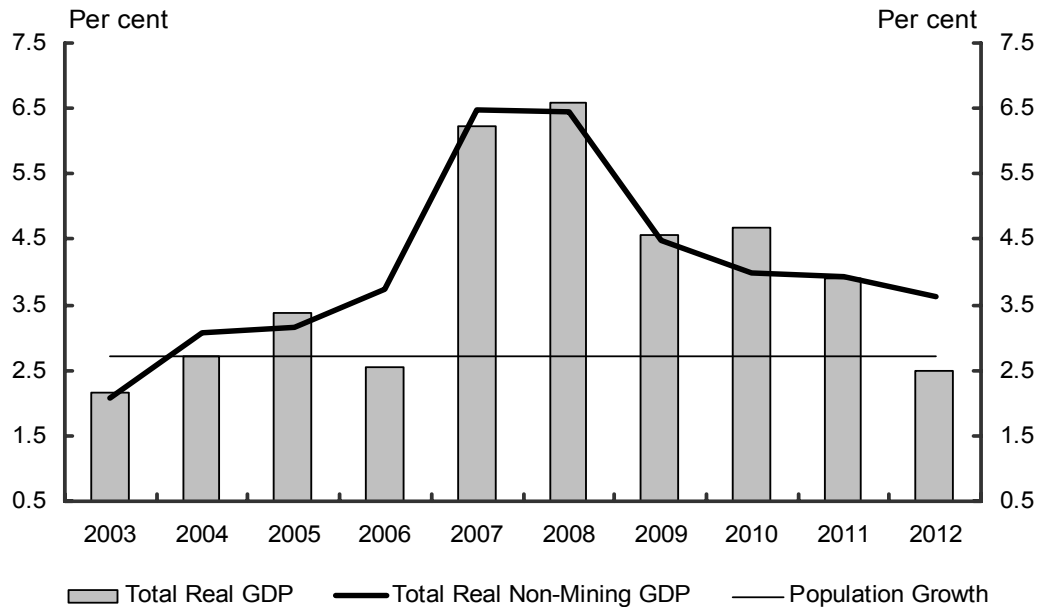
8.3 GROSS DOMESTIC PRODUCT OUTLOOK

8.3.1 Overview

PNG's outlook for 2008 is for continued strong real economic growth which is expected to rise to 6.6 per cent, with non-mining GDP also growing strongly at 6.5 per cent.

After five years of economic growth averaging at 2.1 per cent, 2007 and 2008 are expected to be substantially stronger, with growth in excess of 6 per cent in both years. This represents the strongest growth since 1996, and the strongest consecutive two years of growth since the oil driven growth of the early 1990s. With real economic growth expected to be significantly above population growth, the average standard of living, measured by GDP per capita, is expected to increase by around 7 per cent over 2007 and 2008. However, strong economic growth needs to be sustained over the medium term in order for the population to notice a discernable improvement in the standard of living.

This improved economic outlook stems from a combination of the commodity price boom arising from positive international developments, political stability, microeconomic reforms, prudent macroeconomic policies and low interest and inflation rates.

Figure 21: Real Economic Growth 2003-2012

Source: Department of Treasury

With signs of expansion in most sectors of the economy, the Government will need to pursue structural reforms aimed at sustaining and improving economic growth prospects. The positive impact of microeconomic reform in the telecommunications sector on services, employment, prices and growth provides a guide to the potential benefits of reform in other sectors.

Over the medium term, the economy is expected to continue to grow but not at the same strong rate forecast in 2008. This largely reflects the natural decline of existing oil reserves, as well as the maturing of the mobile phone market.

Government expenditure on infrastructure improvement should help to sustain the high levels of activity – particularly in the building and construction sector. However, with large amounts of Government funds remaining in trusts awaiting distribution, actual Government expenditure will need to be monitored carefully and spread out over the medium term in order to ensure that the fiscal stimulus does not overheat the economy. This is especially the case given the already building inflationary pressures.

Towards the end of the projection period, GDP growth is expected to come off with the decline in oil production and the winding down of some of the major mining projects. While some of the major potential projects that are currently being announced could commence over the projected period, they are not yet sufficiently certain to include them in the projections. However, some proposals are extremely large and will have a big positive impact on the economic growth outlook if one or more of them proceed.

8.3.2 Agriculture, Forestry and Fisheries

The Agriculture, Forestry and Fisheries sector is projected to grow by a robust 4.9 per cent in real terms in 2008.

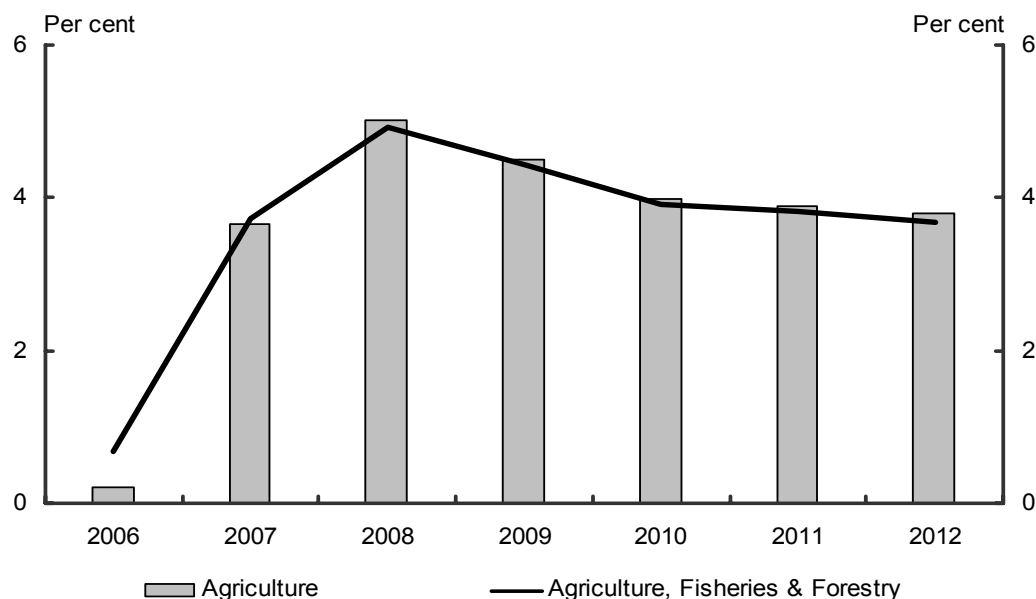
The Agriculture sector is forecast to grow by 5.0 per cent in real terms in 2008 reflecting higher production of major cash crops including palm oil, cocoa, coffee and copra oil for export, as well as increased production for domestic consumption. In the outer years, agriculture production is expected to continue to grow solidly.

Rapid expansion in this sector is hindered by structural rigidities such as poor transport infrastructure and the high cost of utilities such as electricity, water and telecommunication. To assist in overcoming these difficulties, the Government remains committed to developing the non-mineral sector. In 2007, the Government approved the National Agricultural Development Plan to help growth in the agriculture sector. In addition, more funds have been allocated to the Maintenance and Transport Infrastructure sector to further improve accessibility to markets and boost output.

The Forestry sector is estimated to gradually decline in 2008 and into the medium term, with the expiration of a number of current timber permits more than offsetting new impact projects coming into operation.

The Fisheries sector is expected to grow at a solid rate of 3.5 per cent in 2008, on the back of strong growth achieved in previous years and the improved investment climate.

Figure 22: Agriculture, forestry and fisheries sector growth



Source: Department of Treasury

World prices of PNG's major agricultural commodities are projected to be relatively stable in 2008 following very strong growth in 2007. In US dollar terms, cocoa and palm oil prices are expected to be lower than the very high prices achieved in 2007 but higher compared to the average price for the last three years. Over the medium term, the IMF World Price Outlook reports that prices for PNG's major agricultural export commodities are expected to be mixed, with cocoa, palm oil and coffee declining, while prices for logs are expected to increase steadily.

8.3.3 Petroleum and Mining

The mining and quarrying sector is forecast to grow very strongly by 14.2 per cent in 2008, reflecting increased production from the major mines and the commencement of gold production from two new mines, Sinivit and Simberi.

Gold production is expected to increase in 2008 with Porgera and Lihir ramping up production. Ok Tedi is also expected to increase production in 2008. These will be supported by production from the two new mines; Sinivit and Simberi. The former has started production whilst the latter is expected to start operations in late 2007.

Over the medium term, the mining and quarrying sector is expected to grow strongly. This reflects production increasing in the major mines and also additional mining and quarrying production from Ramu Nickel that is expected to commence in 2010. However, towards the end of the projection period, production is expected to decline with the winding down of some major mining projects.

In the petroleum sector, a decline in production of 8.2 per cent is estimated in 2008 following slight growth of 0.9 per cent in 2007. This reflects the natural decline in oil reserve levels at the existing oil fields.

Over the medium term, oil production is expected to continue its declining trend as current oilfields continue their natural decline. Oil production is expected to fall from around 17 million barrels in 2008 to around 10 million barrels in 2012. By 2015, it is estimated that oil reserves could be depleted if there are no new discoveries made in the intervening period. While high oil prices may bring previously unviable fields into operation, this is yet to be demonstrated.

There are two major gas commercialisation proposals that are currently being discussed with Government. These discussions are continuing and the Government is expected to reach a decision in the near future. These potential projects are not included in the projections. Any gas production arising from these potential projects would not commence until towards the end of the projection period. However, the construction period of a large gas project would have a substantial impact on economic growth.

In terms of prices for 2008 used for Government revenue forecasts, gold is expected to be below the very high prices experienced in late 2007 but remain high at around US\$662/oz. The price of copper is also expected to ease to US\$5400/tonne. Over the medium term, oil and gold prices are projected to remain steady, reflecting continued strong global demand and a muted supply response, while the price of copper is expected to come off gradually from current high levels as supply increases.

The US dollar crude oil price is expected to be lower in 2008 than the record high levels experienced in late 2007.

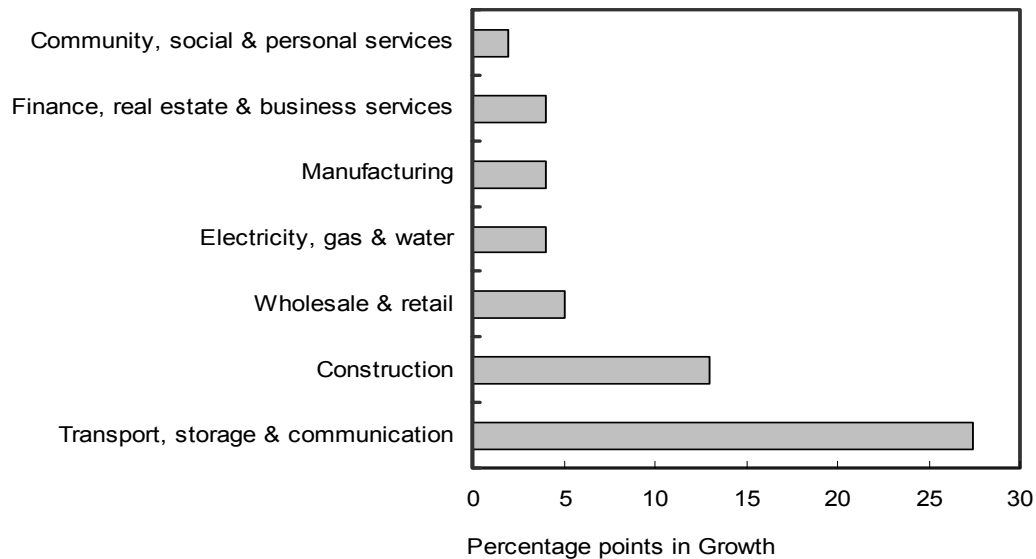
8.3.4 Other Sectors

While less information is available on prospects for the non-commodity sectors of the economy, most sectors of the economy are expected to contribute to economic growth in 2008, in line with the general improvement in business conditions and increased Government expenditure on the maintenance and rehabilitation of public infrastructure.

The Transport, Storage and Communication sector is expected to grow extremely strongly in 2008 by 27.4 per cent, as existing and new providers to the mobile phone segment of the market continue to expand services, before slowing in later years as the market matures.

Other non-commodity sectors are also expected to grow broadly in line with increased overall economic activity. This will be assisted by increased government spending on transport infrastructure and with the development of several new mineral projects in the short to medium term.

That said, the medium-term outlook for the non-commodity sectors depends on continued macroeconomic stability and on the Government addressing structural issues impeding the economy's competitiveness and productivity.

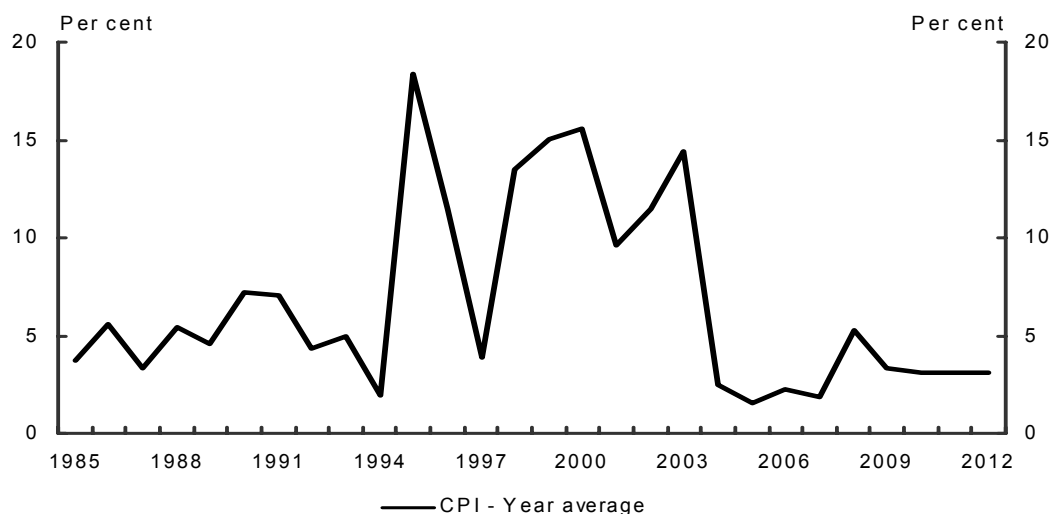
Figure 23: Expected Sectoral Growth in Non-Commodity sectors in 2008

Source: Department of Treasury

8.4 PRICES

Annual inflation as measured by the consumer price index (CPI) is projected to be 5.2 per cent in 2008. This outlook reflects the build up in inflationary pressures from the fast growth in money supply, the increased terms of trade and the fiscal stimulus from the Supplementary Budgets in 2006 and 2007. Furthermore, the expected government spending arising from the 2007 Supplementary Budget and 2008 Budget, especially on maintenance and infrastructure projects, will inject further stimulus into the economy as the funds for the projects are used to buy goods and services.

Over the medium term, annual average inflation is expected to average around 3.1 per cent reflecting ongoing fiscal discipline, an easing in government expenditure and sound monetary and wages policy.

Figure 24: Inflation outcome and Projection (1985-2012)

Source: Department of Treasury, NSO

8.5 EMPLOYMENT AND WAGES

Employment has generally improved in 2007 and is expected to further strengthen in 2008. This reflects increased private sector investments, particularly in the non-mineral sector including construction, and increased Government spending on public sector infrastructure and maintenance. The strong demand for labour continues to respond to the strong growth in real GDP.

Strong employment growth reflects a broad economic recovery and the strong platform that the Government has built over the years. New mining projects have boosted employment growth and the likelihood of further strengthening of the economy. A sustained increase in employment is expected from agriculture, construction, transport and communication and the wholesale and retail sectors.

Given the allocation of Government windfall revenues in 2006, 2007 and 2008, the implementation phase is expected to spread through 2008 and beyond. This is aimed at addressing impediments on business, and improving inadequate public infrastructure in transport, communication, electricity, education and health and the agriculture sector. This is expected to further boost the economy and employment prospects.

The new public sector wage agreement for 2007 to 2009 links improvements in the remuneration structure and pay increase to increases in productivity and performance. Over the three year period, the bulk of pay increases will be affected through the increment structure. The agreement will ensure affordable and sustainable wage increases in real terms that should assist to keep inflationary pressure low.

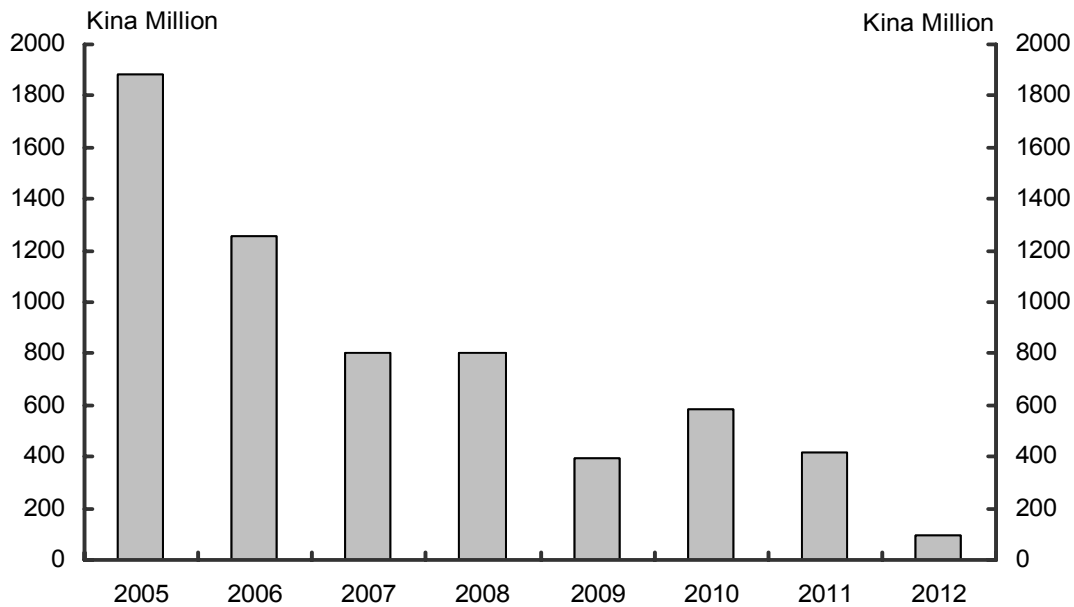
8.6 BALANCE OF PAYMENTS

In 2008, the current account surplus is expected to be K806 million (4.1 per cent of GDP). This is slightly higher than in 2007 due to the value of imports falling by more than the value of exports. The value of exports is expected to fall slightly in 2008, in line with falling mineral prices which is partially offset by rising volumes of export as new projects come into full production.

The value of imports is also expected to fall due to lower capital goods imports following very large imports in 2007. This is partially offset by continued strong non-mineral import growth.

For the income and transfer balance, it is projected that there will be increased outflows of income as mining companies realise large profits from higher volumes of exports and continued high mineral prices.

Over the medium term, the current account surplus is expected to fall steadily in line with a gradual reduction in export values, reflecting lower volumes and prices and higher levels of imports in line with increased domestic growth.

Figure 25: Current Account Balance (Kina Millions)

Source: BPNG for 2005 & 2006, Department of Treasury for 2007 to 2012

8.7 MONETARY POLICY

Monetary Policy formulation and implementation is the responsibility of the independent Bank of Papua New Guinea.

Interest rates have continued to remain below the KFR of 6 per cent since 2005. However, there are concerns that inflationary pressures are rising with excess liquidity building up due to the fast growth in money supply, particularly currency in circulation that has risen over the last two years. Monetary policy will need to be closely monitored to ensure that these pressures are contained. Margins between deposit and lending interest rates in the financial sector remain high.

The Government's policy is that exchange rate should be determined by the market and implemented by the independent Bank of Papua New Guinea. Consistent with Government policy, the exchange rate will continue to be set by the market in 2008, with the Bank of Papua New Guinea using foreign reserves only to perform the role of appropriately managing short-term exchange rate volatility.

The Government will continue to support the conduct of monetary policy through the continuation of prudent fiscal policy, the progressive shift to a productive wages policy and the allocation of additional revenues to capital investment in areas that will improve the productivity of the economy.

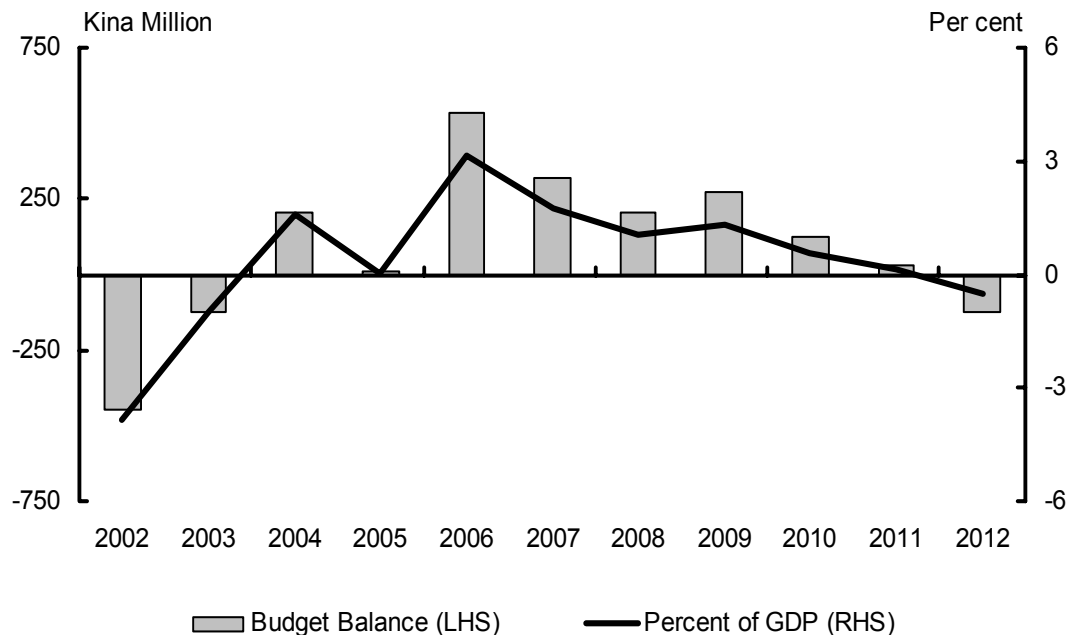
8.8 MEDIUM TERM FISCAL OUTLOOK

8.8.1 Overview

The medium term fiscal outlook has been prepared in the context of the proposed new Medium Term Fiscal Strategy (MTFS) 2008-2012 which aligns recurrent and development expenditure with 'normal' revenues (those revenues that could be expected in the absence of a commodity boom) over the forecast period. This is based on conservative and achievable estimates for economic growth and revenues.

Total Revenue and Grants are expected to decline over the medium term in line with projected declines in mineral commodity prices, declines in oil production and the winding down of some major mining projects. The government is focusing on spending additional revenue in priority areas including public infrastructure maintenance and development that will be spread out over the medium term such that when revenues fall, these improved areas can help to sustain growth in the non- mineral sector.

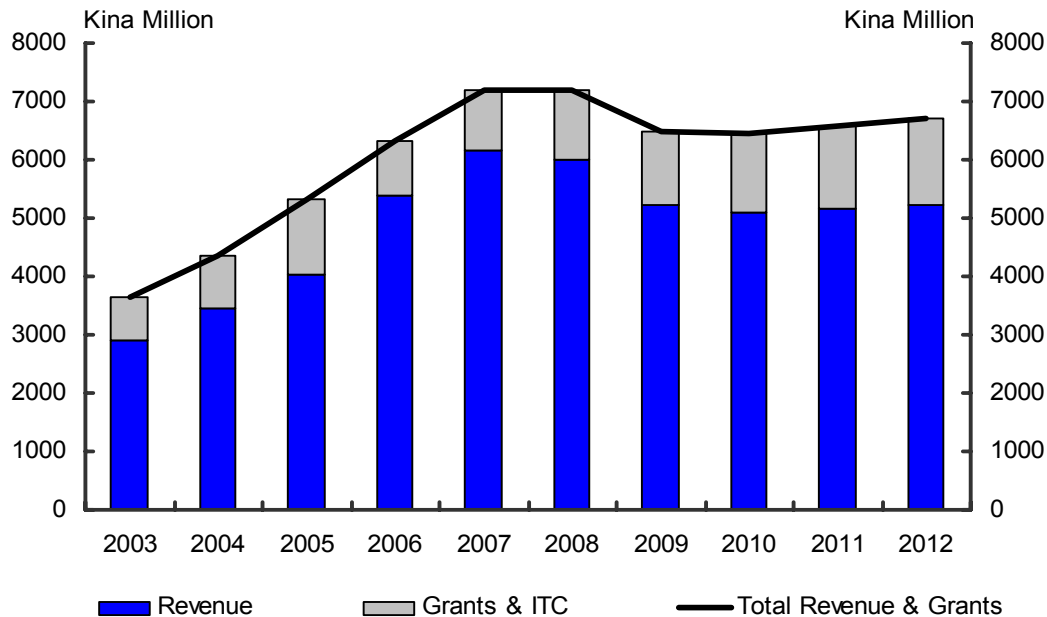
Figure 26: Medium Term Fiscal Outlook



Source: Department of Treasury

8.8.2 Revenue and Grants

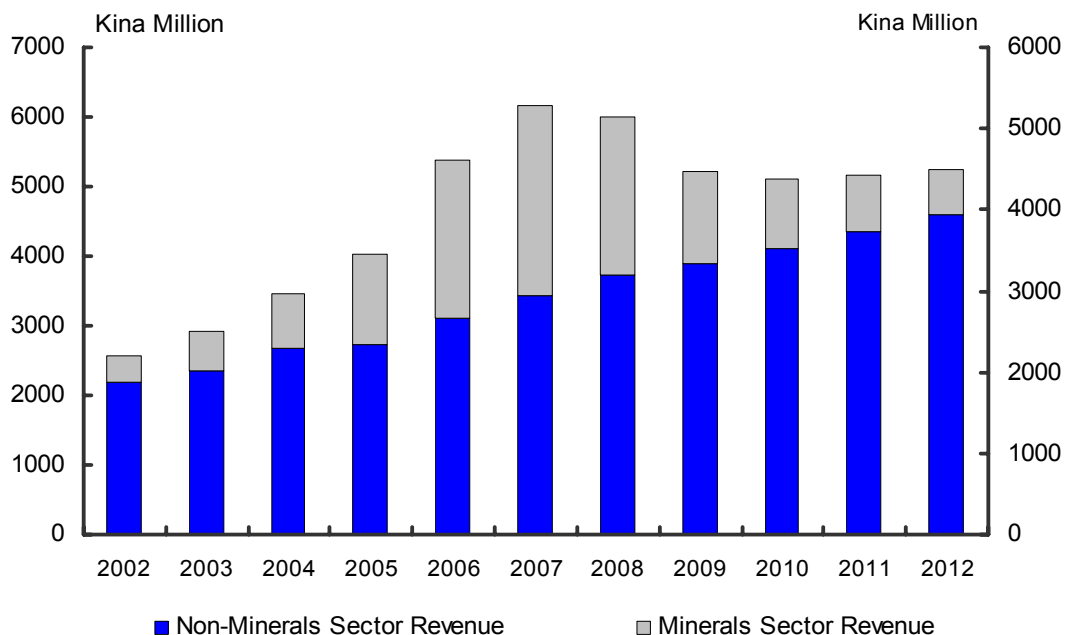
Total Revenue and Grants are forecast to decline from K7,201.7 million in 2008 to K6,721.4 million in 2012, reflecting declining minerals tax revenue that are partially offset by growth in non-minerals revenue. As a percentage of GDP, total revenue and grants are expected to decline from 36.5 per cent in 2008 to 28.5 per cent in 2012. While there are some projects that are expected to come on stream (Ramu Nickel, Simberi, Sinivit) during the projection period and contribute to GDP, they will not be in a position to pay income tax.

Figure 27: Total Revenue and Grants 2003-2012 (Kina Millions)

Sources: Department of Treasury, Department of National Planning and Monitoring

8.8.2.1 Revenue

Government Revenue is projected to fall from K6,004.3 million (30.4 per cent of GDP) in 2008 to K5,238.8 million (22.2 per cent of GDP) in 2012. Mineral revenue is expected to gradually decline in line with projected price declines, while non-mineral revenues are expected to continue to grow in line with economic growth.

Figure 28: Minerals and Non-Mineral Sector Revenue 2002 – 2012 (Kina Millions)

Source: Department of Treasury

8.8.2.1.1 Tax Revenue

Tax Revenue is projected to fall from K5,516.8 million in 2008 to K4,999.4 million in 2012. Mining and Petroleum Taxes are projected to decline from K2,011.8 million in 2008 to K583.8 million in 2012. This includes the natural decline in oil production, the projected decline in prices in the outer years as well as new mining projects coming into operation but not able to pay income tax.

However, other non-mineral tax revenue such as personal income tax, company tax, GST and import duty are expected to be stronger in 2008 as well as into the outer years in line with continued economic growth, though not large enough to offset the decline in mineral tax revenue and phasing out of the mining levy.

8.8.2.1.2 Non-Tax Revenue

Non-Tax Revenue is projected to decline from K487.5 million in 2008 to K239.4 million in 2012, mainly reflecting lower dividends from the State's 15 per cent share of the Ok Tedi mine due to assumed lower price projections.

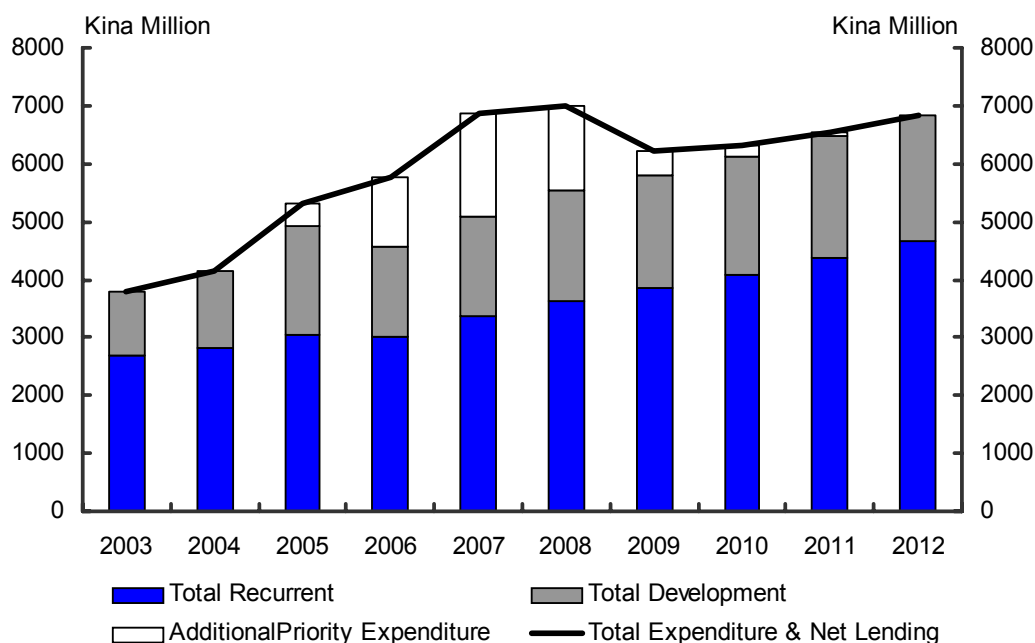
8.8.2.2 Grants

Grants are provided at the discretion of donors. In the medium term, total grants are estimated to increase from K1123.7 million in 2008 to K1461.2 million in 2012, mainly reflecting an expected increase in AusAid's grant of 8 per cent each year starting in 2009.

8.8.3 Expenditure and Net Lending

Total Expenditure is expected to decline from K6,999.4 million (35.5 per cent of GDP) in 2008 to K6,847.8 million (29.1 per cent of GDP) in 2012. This decline is in line with the expenditure profile in the new proposed Medium Term Fiscal Strategy 2008 to 2012 where forecast additional mineral revenue declines with assumed lower mineral prices and natural decline in oil reserves and closure of some major mines.

Figure 29: Total Expenditure and Net Lending 2003-2012 (Kina Millions)



Source: Department of Treasury, National Planning and Monitoring.

8.8.3.1 Recurrent Expenditure

Total Recurrent Expenditure is projected to increase from K3,636.3 million in 2008 (18.4 per cent of GDP) to K4,653.8 million in 2012 (19.8 per cent of GDP).

Total Government personnel emoluments expenditure is projected to increase by an average annual growth rate of 6.5 per cent over the medium term. The increase for personal emoluments expenditure includes increase funding provisions for superannuation and public servants' pay increases.

Goods and Services Expenditure by National Departments is projected to increase from K1,330.2 million in 2008 to K1,729.7 million in 2012 by applying indexation for general price increase. It also includes additional expenditure from projected normal revenues in the forecast period based on the proposed new Medium Term Fiscal Strategy.

Education subsidy funding is projected to increase to take into account the population growth and inflation as well as an additional K100 million per annum allocated over the medium term.

Goods and Services Transfers by Provincial and Regional Governments allow for the expected cost of the new arrangements for Intergovernmental Government Finance, expected to commence in 2009. For the 2008 Budget the interim financing arrangements and funding levels introduced in the 2004 Budget will be maintained.

Transfers to Statutory Institutions are projected to increase by the estimated inflation rate over the medium term. Nevertheless, it is expected that over time agencies should become increasingly self-funding and looking to cost savings and productivity gains to fund additional expenditures themselves.

Interest payment and fees on existing debt are projected to increase moderately over the medium term, reflecting the shift away from high-risk external debt to domestic debt, consistent with the Medium Term Debt Strategy, which is partly offset by the lower interest payment due to the external repayment of debt.

8.8.3.2 Development Budget

Domestic Funds from the Development Budget expenditure is expected to increase from K526.7 million in 2008 to K548.4 million in 2012. The projected increase in domestic funds provided for development spending over the medium term reflects the Government's commitment to shift resources to development spending as specified in the Medium Term Development Strategy (MTDS).

8.8.3.3 Additional Priority Expenditure

The additional priority expenditure has been sourced from additional mineral revenues using the proposed new MTFS and will be used for investment purposes or the repayment of debt or other liabilities. It will be spread over time to ensure maximum benefit and in order to reduce inflationary pressures. This is highly likely to be variable, in line with volatile commodity prices.

8.8.4 Financing

The medium term outlook is consistent with the proposed new Medium Term Fiscal Strategy. As a result, financing requirements are expected to be manageable over the medium term with expected moderate Budget surpluses to be used for debt repayment.

8.8.5 Public Debt

Government indebtedness is expected to decline under the Government's proposed new Medium Term Fiscal Strategy. Fiscal consolidation, coupled with economic growth, is projected to yield successive declines in the debt-to-GDP ratio, from current levels of 34.9 per cent of GDP in 2007 to 25.4 per cent of GDP in 2012.

CHAPTER 9. MEDIUM TERM FISCAL STRATEGY

9.1 OVERVIEW

The Department of Treasury has produced a draft of a new Medium Term Fiscal Strategy (MTFS) for 2008-2012, and used it as a framework for the strategy of the 2008 Budget. It is currently consulting stakeholders inside and outside the Government, including PNG's development partners, on the draft Strategy. When that is done, the Minister for Treasury and Finance is likely to ask NEC to consider and agree to the new MTFS, and to approve its publication. This chapter contains a summary of the draft Strategy.

9.2 RATIONALE

The rationale of this strategy is:

- firstly to provide a stable framework for the Government to use its fiscal resources to serve the National Goals in the Constitution and the objectives of the Medium Term Development Strategy (MTDS);
- secondly to develop further the strategy followed in 2002-2007 for handling varying amounts of additional revenue from PNG's commodity exports; and
- thirdly to contribute to partnership between the Government and the private sector by making it clear that the Government will conduct public-sector investments and borrowing within a sound fiscal framework.

9.3 BACKGROUND

The first Medium Term Fiscal Strategy (MTFS), for 2002-2007, was directed towards arresting a decline in economic performance in PNG, and it played a key role in turning around both Government finances and the overall economy.

However, the first MTFS has been overtaken by events. From 2005 to 2007, PNG has enjoyed an extraordinary surge in revenues resulting from the commodity price boom. In this situation, the goal of balanced budgets contained in the first MTFS is less than what is needed for prudent fiscal management.

9.4 MINERAL REVENUE-HOW MUCH IS RELIABLE?

Mineral revenues, from mining and petroleum tax (MPT) and associated dividends, are expected to continue at unusually high levels in 2007 and 2008, then decline in line with production and price movements. Total mineral revenue over the period 2008-2012 is currently forecast at just under K7 billion.

But commodity prices are highly volatile and no one can confidently predict which way they will move. This is the biggest risk in basing plans for ongoing spending on revenue derived from high commodity prices. The Government would have to make difficult decisions to reduce expenditure if prices were to drop suddenly. Other risks to mineral revenue include natural disasters and landowner disputes which could disrupt production.

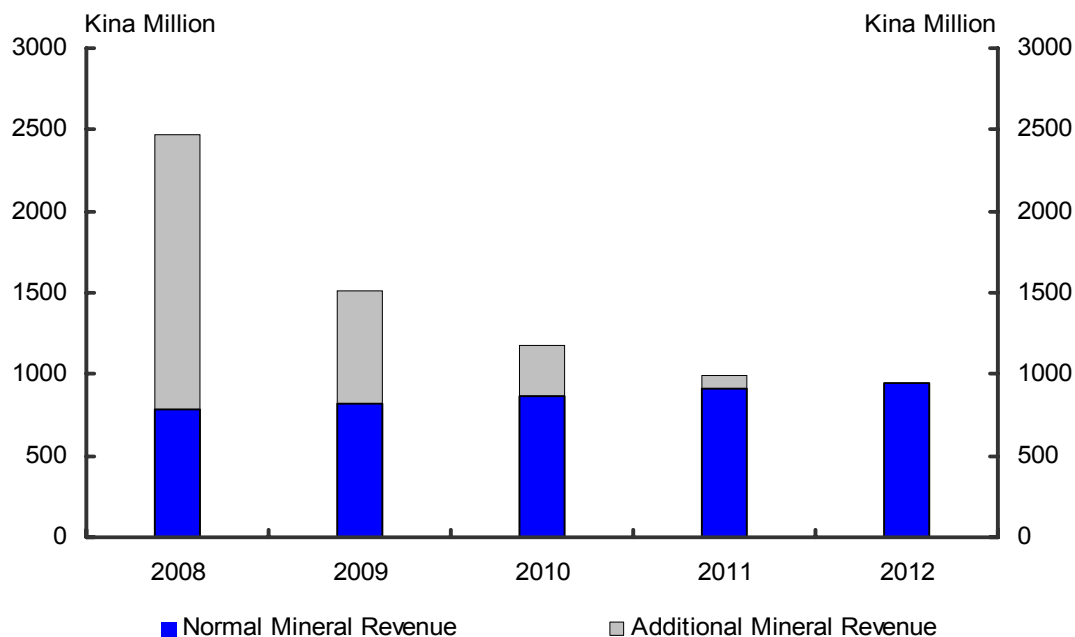
In formulating the new MTFS, a key step is defining how much of the expected mineral revenue can be regarded as normal — that is, expected even in the absence of a commodity boom, and reliable as a source of funds for ongoing spending. This normal component of mineral revenue can prudently be included in the amount allocated for spending in the recurrent and development budgets.

The rule in this strategy is that **only the component of expected mineral revenue equal to 4 per cent of GDP will be used to fund ongoing spending**. The remainder of mineral revenue is to be regarded as additional revenue, to be allocated in ways which can be adjusted, with a minimum of disruption, when the amounts received vary from their forecasts and fluctuate from year to year.

The 4 per cent rule will be reviewed after two years, or earlier if developments such as production shortfalls or changes in price outlook mean that an overall Budget deficit occurs or becomes likely. In those circumstances, spending plans would be cut, or a temporary Budget deficit would be necessary, or both.

Figure 30 shows the current forecasts for each year of the MTFS period 2008-2012 of mineral revenue, with its normal and additional components.

Figure 30: Normal and additional mineral revenue, 2008 - 2012 (Kina Millions)



Source: Department of Treasury

9.5 ALLOCATION OF ADDITIONAL MINERAL REVENUE

There are four key principles which apply to the choice of ways in which mineral revenue above the 4 per cent of GDP threshold will be allocated.

Benefits for future generations — because mineral revenue is derived from once-only extraction and sale of PNG's non-renewable resources, it should be used also for investments that will benefit future generations.

- Some of the best investments for future generations are the basic services and infrastructure which are defined as priorities for spending in the MTDS.

Flexibility — uses of additional mineral revenue should be of kinds which will not be disrupted if the amount of revenue received varies from the forecast during the year for which plans are being made. Repayment of public debt is the most obvious use of this kind, and it is already the standing use for additional revenue received too late in the year to be the basis for additional appropriations.

Consideration of impacts on domestic and import demand — uses of additional mineral revenue should be chosen so that they do not make overall demand by the Government for non-government goods and services within PNG fluctuate through time by large amounts. This may mean that some uses of large amounts will need to be phased over several years. Uses which involve mainly demand for imports into PNG will not add much to demand, but their effect on PNG's external position will need to be considered.

Basis for comparison — investment projects which are potential uses for additional mineral revenue should be –

- compared with each other in terms of their expected net benefits, adjusted for the risks which attach to the receipt of benefits; and
- compared with other possible uses of funds in the context of formulating annual budgets, so that Ministers can make the best informed decisions about how to allocate scarce funds.

Applying the four principles stated just above to PNG's likely situation in the period from 2008 to 2012 suggests that there are two preferred areas for allocating additional revenue, and that each year's budget will involve a carefully balanced choice between them:

- additional public investments, and
- repayment of public debt.

9.6 ADDITIONAL PUBLIC INVESTMENTS

Public Investments seem to many people the most attractive option for use of additional revenue. But in order for public money to be well spent, the Government must carefully assess in every case of a prospective investment –

- **implementation capacity** — whether the project can be implemented effectively, in addition to everything else to which the Government is committed, within the constraint of available capacity in the public service and in relevant areas of the private sector; and
- **net benefit threshold** — whether the expected margin of benefits over costs, with all the associated risks factored into the assessment, represents a better proposition than the assured benefit of reducing public debt and thereby saving on interest cost.

Very large prospective investments, such as State equity stakes in gas commercialization or other resource development projects, involve some added factors –

- assessing investments may be a complex task for which specialist advisers need to be contracted;
- Investments may need to be funded from more than one year's additional revenue; and
- the concentration of risks in the State's financial outlook may represent a constraint on the size of the investment that can prudently be made, in addition to the constraints on available budget and debt funding.

9.7 REPAYMENT OF PUBLIC DEBT

This is the other option for use of additional revenue. In mid-2007 PNG had K6,541 million of public debt, with K2,992 million in domestic debt and the equivalent of K3,459 million in external debt. The advantages of repaying public debt are as follows:

- It would have an immediate positive effect on the spending side of the Budget, freeing resources every year from debt servicing which could be used for service delivery, maintenance of public infrastructure, or new investments;
- Debt repayment strengthens the Government's financial position or "balance sheet", which increases investors' confidence and helps to lower interest rates. This reduces the borrowing costs of all PNG households and businesses; and
- Debt repayment also reduces the interest rate risks and foreign exchange rate risks for the Budget — if interest rates rise, or the currency depreciates, the impact on interest expenses will be smaller. This provides the greatest flexibility for future Budgets, including for further financing of State investments when necessary.

Apart from public debt, there are **other State liabilities** which it would be helpful in much the same way to repay or reduce. The State's liability to Nambawan Super Ltd (formerly POSF), in respect of public servants for whom the employer contributions to superannuation are as yet unpaid, is the largest one.

The **choice each year** between additional public investments and repayment of public debt should be made through –

- rigorous evaluation of prospective public investments;
- allocation to them of appropriate amounts in a regular or supplementary budget process; and
- allocation of the remainder to repayment of public debt.

Such a process could result in any combination of additional public investments and repayment of public debt depending on what feedback the Government is getting from implementation efforts. It will also depend on the state of the economy, especially if there are inflationary pressures.

But as a guideline or starting-point for the budgeting process, this strategy contains a 60:40 guideline — **60 per cent additional public investments and 40 per cent repayment of public debt.**

An important reason for devoting a substantial proportion of additional revenue during the period 2008-2012 to repayment of public debt, even if there are worthwhile public investments which could be effectively implemented, is the prospect that after this period PNG may face more difficult times, which will make greater demands on budgets and the State's balance sheet. This is because –

- a number of major **resource projects** are due to be wound down within the next decade, significantly reducing mineral revenues;
- the epidemic of **HIV-AIDS** is growing and is likely to cause large and mounting costs; and
- **climate change** is likely to affect both PNG's propensity to natural disasters, and the climatic conditions for PNG's agricultural industries including fisheries.

It will therefore be prudent to aim at ending the MTFS period with stronger State finances than at present.

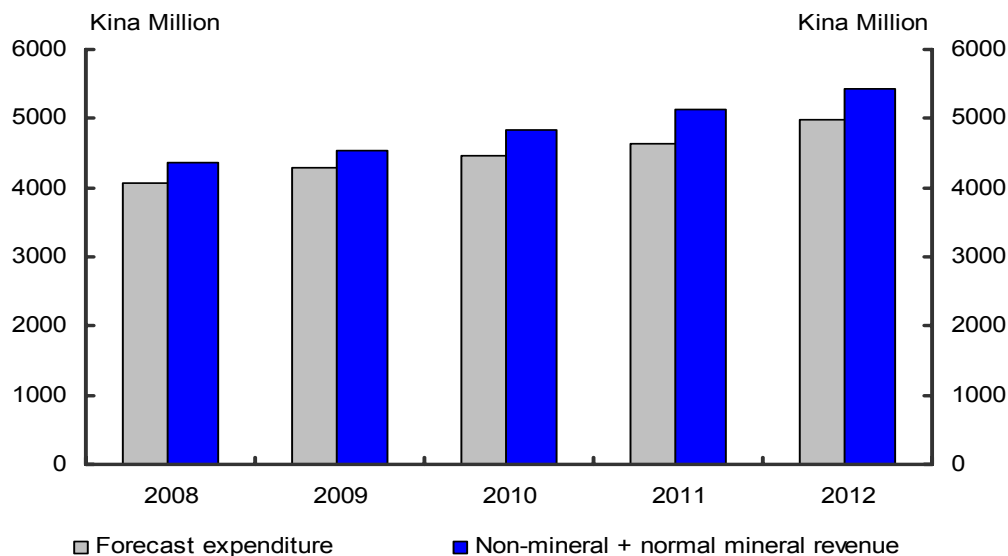
9.8 IMPLICATIONS FOR ONGOING EXPENDITURE

The main implications of this proposed strategy for ongoing spending are –

- that the amounts of ongoing spending will be fairly stable from year to year; and
- that if forecast expenditure is less than the sum of normal mineral revenue and non-mineral revenue – what can be called total normal revenue – then expenditure could be increased up to that sum, while staying within a prudent fiscal framework.

Before Ministers made decisions on the 2008 Budget, the Department of Treasury forecasted that with no changes in relevant Government policies, ongoing spending would remain less than total normal revenue in the MTFS period. This is shown in Figure 31.

Figure 31: Forecast expenditure compared with total normal revenue, 2008 - 2012
(Kina Millions)



Source: Department of Treasury

Therefore under this strategy there is scope for policy decisions, such as those in the 2008 Budget, which would increase ongoing spending to levels corresponding to total normal revenue.

At the same time, it will be crucial for the success of this fiscal strategy that ongoing spending be kept each year within the limit of total normal revenue. This is vital in order to ensure that ongoing spending can be sustained.

9.9 IMPLICATIONS FOR BUDGET AND PUBLIC DEBT

The overall (or “headline”) balance in each year’s Budget will depend on –

- whether ongoing spending is kept within its limit of total normal revenue; and
- how additional mineral revenue is allocated between public investments and debt repayment — since public investments are recorded in the Budget as “above the line” spending, while debt repayment is not.

If the proposed 60:40 guideline were applied in allocating additional mineral revenue, the pattern of balances would be a declining series of surpluses in 2008-2011 and a deficit in 2012.

The counterpart of that series of overall balances would be a series of reductions in public debt in 2008-2010, by amounts equal to the 40 per cent components of additional mineral revenue, and a small increase in 2012.

On the basis of current forecasts of GDP growth, this would mean over the MTFS period a substantial further reduction in the ratio of public debt to GDP, to about 25 per cent at the end of the period.

Bringing the public debt to GDP ratio down to the 25 per cent level would represent a major fiscal achievement. It would make it more likely that according to the measure used by the International Monetary Fund (IMF), PNG's public debt would be assessed as sustainable. This lower public debt level would also be a positive factor in the rating agencies' ratings of PNG's sovereign debt. These kinds of international recognition for a lower debt level would, in turn, contribute to business and investor confidence in PNG.

9.10 FUNDING OF INVESTMENT PROJECTS

Funding for investment projects can come both from the Budget and from additional State borrowing.

9.10.1 Budget funding

The five-year total of additional mineral revenue represents the limit on what will be available from the Budget for funding of investment projects.

- If additional mineral revenue is received as currently forecast, and allocated by the 60:40 guideline, this would provide K1,649 million for public investments.
- Alternatively, if the 60:40 guideline were over-ridden, all K2,749 million could be used for public investments.

9.10.2 State borrowing

The scope for State borrowing to supplement funds from the Budget, while keeping to a prudent debt strategy, is not great. This is because prudent use of State borrowing would not allow the overall level of public debt to rise again, past its level at the start of the Government's current term in August 2007.

The *Fiscal Responsibility Act 2006* contains principles of sound fiscal management. One is that the Government will not raise the overall level of public debt during its term.

- This principle would be applied if a period of net repayment of debt, while additional mineral revenue was being received in large amounts, was followed by some net borrowing in later years – provided the net borrowing did not raise the level of public debt past its level at the start of the Government's term.

9.10.3 Project borrowing

The limit on funding of investment projects from the Budget and from additional State borrowing does not apply to:

- investment projects by State-owned enterprises (SOEs) which the SOEs fund by themselves; and

- investment projects with funding arrangements fully independent of the State.

For example, if projects can be designed as public-private partnerships, so that private investors supply the funding needed beyond what SOEs can fund through their own operations, their direct effects would be outside this strategy.

However, if project funding arrangements involve contingent liabilities for the State, or could reduce the value of State assets including ownership interests in SOEs, they would have actual or potential effects on the State's creditworthiness and ability to borrow when necessary.

Therefore, when investment projects involve SOEs or are sponsored by the State, the indirect effects of funding arrangements for those projects need to be carefully identified, and the Government's direction of such arrangements needs to be integrated with implementation of this MTFS.

9.11 MAINTAINING THE TAX BASE

A major challenge for the Government in pursuing this strategy is to maintain the integrity of the tax base.

The tax system is severely compromised when concessions are provided to specific projects or taxpayers.

- The use of project agreements to create special tax arrangements for individual projects has encouraged a wide range of investors to seek a growing list of tax concessions, even when forms of tax relief are already provided by the tax law for investors in the type of business involved.
- Project agreements containing project-specific tax concessions have created an uneven playing field on which businesses have to operate.
- Often the concessions sought are difficult to cost, but in many cases they could deprive the Government of significant amounts of revenue.

To enhance the integrity of the tax system, concessions provided to projects should be confined to those available for the relevant industry in the existing tax law.

- This would ensure equitable treatment of projects in each sector, and transparency in tax policy.
- The assurance of equitable treatment for all investors would encourage further investment in the economy.

CHAPTER 10. MEDIUM TERM DEBT STRATEGY

10.1 OVERVIEW

10.1.1 Objective

The objective of the Medium Term Debt Strategy 2008–2012 (the Debt Strategy) is to minimize the cost of debt consistent with the Government's tolerance for financial risk. This objective supports the Medium Term Fiscal Strategy (MTFS) and Medium Term Development Strategy (MTDS).

There are three major strategies to support the objective: reducing debt to sustainable levels; reducing financial risk to prudent levels; and developing the Government Inscribed Stock, Bill and Loan markets.

10.1.2 Why management of the Government debt is important

Management of the Government's debt is important because the Government has an unsustainable level of debt on some measures, the debt portfolio has excessive financial risks, and the Government debt markets are rudimentary.

Currently the Government's credit rating is BB minus for local currency debt, and B plus for foreign-currency debt – these ratings indicate that the rating agencies consider the Government has an inadequate capacity to meet its financial obligations – or an unsustainable level of debt. The Government will have a sustainable level of debt if it continues to retire debt and once the rating agencies consider we have an adequate capacity to meet our financial commitments or assign a rating of BBB minus or better.

The International Monetary Fund (IMF) uses three key indicators to assess debt sustainability, and one indicator shows the Government has an unsustainable level of debt, while the other two indicators show there is a high but sustainable level of Government debt. These two indicators depend in part upon Government Revenue which is exceptionally high and is expected to decline after the commodity boom.

In the past, excessive interest-rate risk caused domestic interest expense as a percentage of domestic debt to increase to over 12 per cent per annum in 1989, 1990, 1991, 1992, 1995, 2002 and 2003, with a peak of 22 per cent in 2003.

Similarly, excessive foreign-currency risk caused the total of external interest expense plus currency depreciation losses expressed as a percentage of external debt to increase to over 20 per cent per annum in 1990, 1994, 1995, 1997, 1998, 1999 and 2001, with a peak of 50 per cent in 1994.

Such high volatility was due to excessive levels of foreign-currency debt and Treasury Bills, and a lack of fixed-rate long-term Kina-denominated debt.

PNG has a rudimentary primary market for Treasury Bills and Inscribed Stock, with weekly competitive auctions of Treasury Bills and Central Bank Bills, and monthly competitive auctions of Inscribed Stock. However, there is almost no secondary market, and no effective repo market. Furthermore, the foreign-currency market is relatively illiquid, and there are no currency swaps available or other sophisticated financial instruments that can be used to hedge financial risks. Nearly all of the Government's external loans are illiquid with different terms and conditions, making it relatively expensive to administer and hedge these loans.

10.1.3 Achievements in 2007

During 2007, the Government implemented the debt strategy which helped to improve debt sustainability, reduce financial risk of the debt portfolio, and develop the Inscribed Stock, Bill and Loan markets. Debt sustainability is largely determined by the fiscal strategy.

Major achievements from 2004 to 2007

10.1.3.1 Improved Debt Sustainability

- Passed a *Fiscal Responsibility Act* in 2006 with a commitment to firstly, not raise the overall level of debt during each Government's term, and to secondly, obtain prior approval of the Treasurer for any borrowings by public bodies.
- In 2006, K100 million of foreign-currency debt was prepaid from funds made available under the second Supplementary Budget.
- At the end of 2006, K430 million of domestic debt was repaid in line with the Budget surplus.
- In 2007, K297 million was allocated under the Supplementary Budget for prepayment of foreign-currency debts.
- In 2007, K250 million was allocated under the Supplementary Budget as partial settlement of the Government's liability to Nambawan Super.
- In 2007, Standard & Poor's raised PNG's Sovereign Debt Credit Rating to BB- for long-term local currency debt and B+ for long-term foreign-currency debt.

10.1.3.2 Reduced financial risk by improving the composition of debt

- Reduced foreign-currency risk by reducing foreign-currency debt by K369.3 million in 2006.
- Reduced interest-rate risk and refinancing risk by increasing Inscribed Stock by a net of K309 million, and reducing Treasury Bills and other domestic loans by a net of K100 million. This decreased the proportion of the domestic debt that has a variable-rate from 55 per cent at the end of 2005 to 39 per cent at the end of 2006, and is projected to reduce to 30 per cent by end of 2007 and lengthened the average maturity of the domestic portfolio from 1 year to 3.4 years.
- Introduced 3, 5, 7, 10, and 15 year Inscribed Stock consistent with lengthening the maturity to meet the growing investors' preference to have longer dated stocks. Such long-term debt was not viable before 2004.

10.1.3.3 Development of Government's Inscribed Stock, Bill and Loan Markets

The priorities of the Debt Strategy have been updated to reflect the three most important, feasible improvements identified by stakeholders:

Better coordination between Treasury, BPNG and the Independent Public Business Corporation (IPBC).

More frequent, timely and standardised reporting on the Government's debt portfolio.

Continued emphasis on incremental improvements in processes underpinning the Kina-denominated Inscribed Stock, Bill and Loan markets.

- Signing of an Agency Agreement between the Bank of PNG (Central Bank) and Department of Treasury in April 2007.
- Reduction in auction minimum bid from K1 million to K100,000.
- Improved investors' access to timely and standardized reporting on Government debt portfolio by providing 24 hours reporting of results of Treasury Bills and Inscribed Stock auction.
- Established website links to other Debt Management Offices and organisations.
- Improved coordination between the Bank of PNG and Department of Treasury.
- Better coordination between the Project Steering Committee and Project Team in regard to issues affecting the development of the PNG Debt Market.
- Simplified Inscribed Stock auctions by allowing investors to purchase Inscribed Stock with either cash or by switching from Treasury Bills or Inscribed Stock with residual maturity of less than 6 months. Previously, separate auctions were held for cash purchases and switches.
- Assisted Asian Development Bank (ADB) to assess the viability of issuing Kina-denominated concessional loans in 2008.

10.1.4 The Updated Debt Strategy

The Debt Strategy has been updated for the fiscal results of 2007 and is aligned to the fiscal and macroeconomic forecasts for 2008 in the draft MTFS and the Budget.

The Government's current debt portfolio is so significantly different from the norms of a prudent debt portfolio that the strategy to reduce financial risk is clear: reduce excessive net foreign-currency debt; lengthen the maturity of the domestic portfolio; reduce the proportion of variable-rate debt; and develop the domestic market.

10.2 REDUCING DEBT TO SUSTAINABLE LEVELS

The Government will be bound by the principles of the Fiscal Responsibility Act with a commitment to firstly, not raise the overall level of debt during its term, and to secondly, obtain the prior approval of the Treasurer for any new borrowings for public agencies.

The Budget is expected to be in surplus in 2008, with K202.3 million anticipated to be available to repay debt. The combined impact of the 2007 Supplementary Budget and the 2008 Budget is expected to have debt reduced by K497 million and superannuation obligations reduced by K400 million.

The simplest holistic measure of debt sustainability is the Sovereign Credit Rating of PNG, and the Government agreed on a medium-term target of BBB minus for PNG's sovereign credit rating – this is the lowest credit rating that indicates the Government has adequate capacity to meet its financial obligations.

The level of public debt remains relatively high, although some substantial inroads have been made over recent years, with the simple debt to GDP ratio expected to fall to 34 per cent by end of 2007.

The quality of a country's policies and institutions has a major influence on its debt sustainability thresholds. The World Bank's Country Policy and Institutional Assessment classify PNG as a poor performer. If the World Bank assessed PNG as a strong performer then we would have higher debt thresholds and hence have sustainable debt levels. The IMF also considers the external debt (both private and public) when assessing the debt sustainability of a country (see www.imf.org/external/dsa for more details).

10.3 REDUCING FINANCIAL RISKS

10.3.1 Foreign-currency Risk

To reduce the excessive foreign-currency risk the Government will gradually repay foreign-currency debt. The Government will fund the repayments through either increased borrowing in Kina or through budget surpluses.

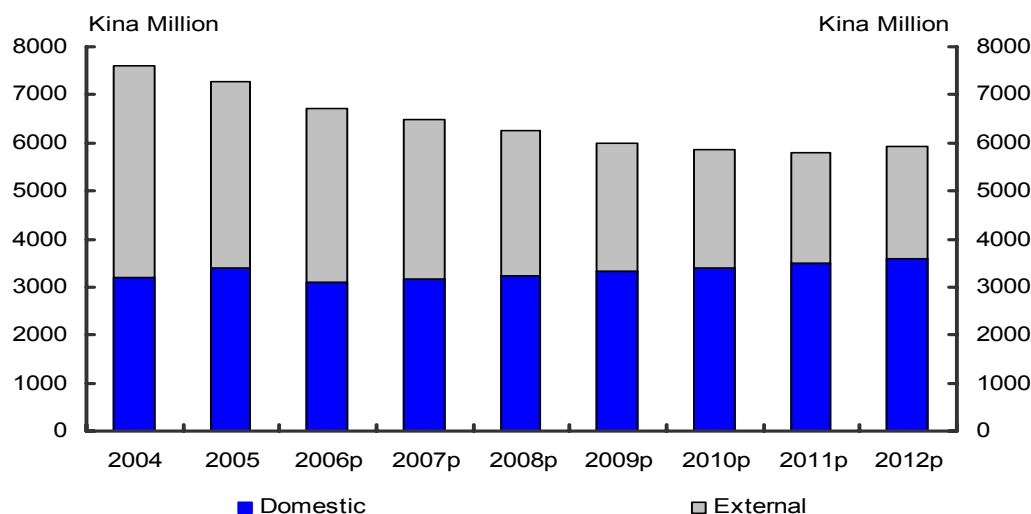
All foreign-currency loans have already been ranked by their risk and cost to identify loans that should be either pre-paid or refinanced or hedged. This analysis was based on asset-liability management principles, and took into account any natural hedge provided by the Government's foreign-currency assets and revenues, including BPNG's reserves. Thus foreign-currency exposures to Japanese Yen and minor currencies will be reduced first as the Government has a net-debt exposure to these currencies.

It is possible that the foreign-currency loans may decrease at a quicker rate than is budgeted. The Government will investigate using Kina-denominated concessional debt from ADB and hedging instruments from the World Bank and ADB to reduce foreign-currency debt or exposure at a faster rate. Finally, the Department of Treasury will request the Government to use any unbudgeted budget surpluses to repay foreign-currency debt.

New foreign-currency loans will still be considered if the loan is highly concessional and in a low risk currency. The criteria for concessional financing shall be a grant element of 35 per cent or more. This is in line with international debt management practice and as recommended by IMF and World Bank. Overall, the repayment of existing foreign-currency debt will exceed any new foreign-currency loans and therefore, there will be net amortization. The Kina equivalent amount of foreign-currency debt will reflect exchange rate changes.

The projected decrease in foreign-currency debt, consistent with the MTFS is shown in Figure 32.

Figure 32: Currency Composition of Government Debt 2004 - 2012 (Kina Millions)

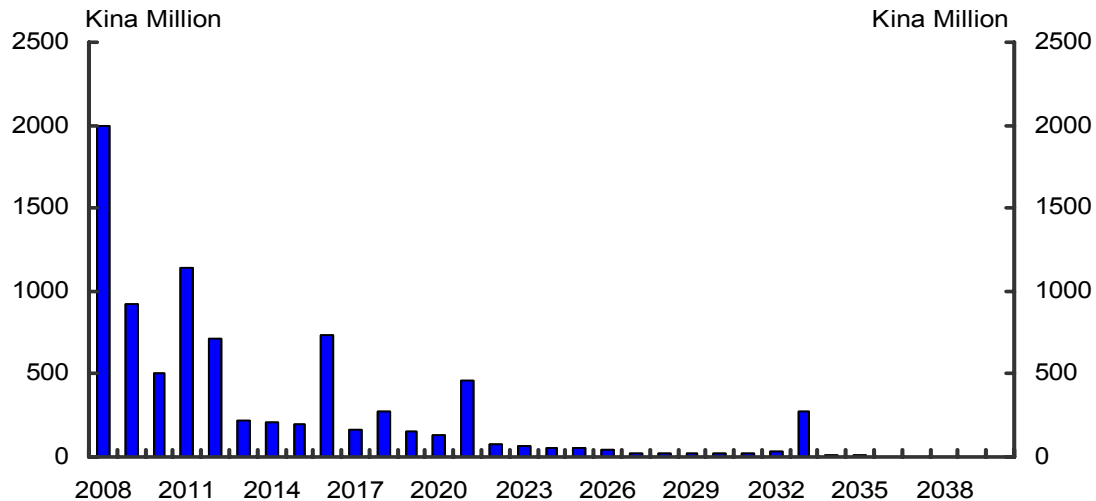


Sources: Department of Treasury

10.3.2 Refinancing Risk

The Debt Strategy will continue to increase the average maturity of the domestic debt portfolio from the current average of about 1 year to about 4 years in 2012. Figure 33 shows the maturity profile of the total debt as at the end of 2007.

Figure 33: Maturity Profile of Total Debt as at 31st December 2007 (Kina Millions)



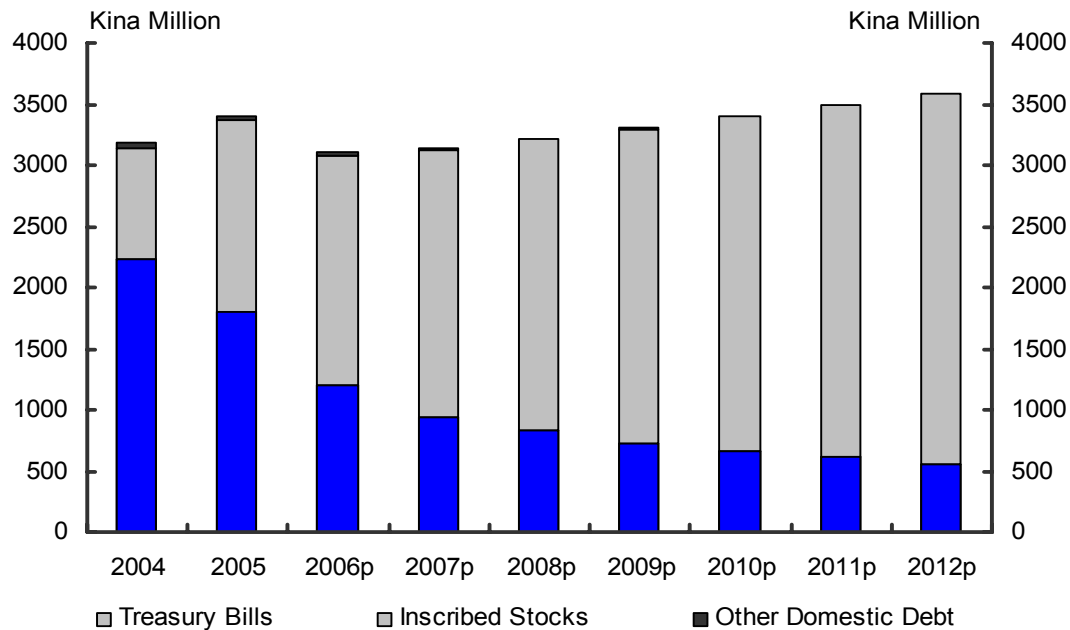
Source: Department of Treasury

The Department of Treasury reviewed its targets for the use of long-term fixed-rate debt relative to short-term variable-rate debt. On average, emerging market countries have only 10 per cent of their domestic debt in Treasury Bills (IMF's Global Financial Stability Report Chapter III). The Government has lowered the target for the proportion of Treasury Bills from 30 - 40 per cent to 20 - 30 per cent. This is an appropriate trade-off relative to industry norms between the additional cost of borrowing long-term fixed-rate debt, and the benefits of stable debt servicing cost and low refinancing risk. A further consideration in changing the Government's target was BPNG successfully issuing a large volume of Central Bank Bills during 2006 and 2007.

The Department of Treasury will achieve this target by increasing the net amount of Inscribed Stock by about K300 million a year over the next five years. This is a quicker rate than anticipated in last year's Debt Strategy due to unexpected higher demand for Inscribed Stock. Figure 34 shows the change in composition of the domestic debt portfolio.

The Inscribed Stock will have maturities between 3 to 15 years, with a limit of K400 million for Inscribed Stock principal maturing in any year. Previously, the annual limit for Inscribed Stock maturing in any year was K500 million and the maximum maturity was 10 years. The limit has now been reduced to K400 million as the Government can spread its Inscribed Stock maturities over 15 years rather than 10 years. The Department of Treasury will reduce the net amount of Treasury Bills by about K200 million a year over the next five years. The targeted rebalancing will take until 2010 to 2012 to achieve due to the large volume of Treasury Bills outstanding.

The external debt portfolio has an acceptably low refinancing risk with an average maturity of 10 years.

Figure 34: Composition of Domestic Debt 2004-2012 (Kina Millions)

Source: Department of Treasury

10.3.3 Interest Rate Risk

In the past, nearly all of the Government's domestic debt had, in effect, a variable interest rate. This exposed the Government to huge swings in debt servicing costs. As previously noted, the Debt Strategy aims to increase the net amount of fixed-rate Inscribed Stock by about K300 million a year over the next five years, and decrease the net amount of variable-rate Treasury Bills by about K200 million a year over the next five years. This will result in about 80 per cent of the domestic debt being fixed-rate, and 20 per cent variable-rate by 2012 as shown in Table 73 below.

Table 73: Composition of Domestic Debt by Instrument

Instrument Type	Current Structure Per cent	Target Range Per cent
Treasury Bills	30	20-30
Inscribed Stock / Other	70	70-80

Source: Department of Treasury

10.3.4 Early Repayment Risk

Some foreign-currency loans have large penalties for early repayment, while some fixed-rate loans can have market values far in excess of the principal of the loan if market interest rates have fallen substantially since the loans were contracted. Thus, there is a substantial risk that the early repayment of foreign-currency debt may be highly expensive.

The Government will request International Financial Institutions to waive prepayment penalties and give PNG substantial discounts for the early repayment of debt. Such discounts are in the best interests of the Government and the International Financial Institutions as they will provide an incentive to reduce overall debt to a more sustainable level and reduce the risk of default. If the International Financial Institutions agree with the Government's request, then the Government will consider repaying foreign-currency loans at a faster rate and conversely repay Treasury Bills at a slower rate.

10.4 DEVELOPING GOVERNMENT INSCRIBED STOCK, BILL AND LOAN MARKETS

In 2008, Department of Treasury will continue with emphasis on incremental improvements in processes underpinning the Kina-denominated Inscribed Stock, Bill and Loan markets to a standard that meets investors' and other stakeholders' expectations. This will include such changes as piloting the listing of some Government debts on the Port Moresby Stock Exchange.

At the end of 2008, Department of Treasury will survey all stakeholders again to re-assess the gap between the management of the Government's debt and leading international practice, and identify the most important, feasible improvements for 2009.

Longer-term strategies include:

- Developing a whole-of-government risk management framework and an asset-liability management framework;
- Development of deterministic and stochastic risk measures and limits;
- Development of sophisticated primary and secondary markets in Kina-denominated Inscribed Stock, Bills and Loans; and
- Use of more sophisticated hedging instruments to improve the composition of the debt portfolio.

These longer-term strategies, while important are not currently feasible given the limited resources and competing priorities of the Government.

These longer-term strategies involve not only investors and financial institutions, but also the judiciary, the legal and accounting profession, regulators, utility providers, industry codes of conduct and qualifications. These improvements are complex and will take many years to implement.

The Department of Treasury will also continue with incremental improvements in monitoring, reviewing and updating annually the Debt Strategy to reflect international and domestic developments relevant to PNG.

APPENDIX 1: REVENUE TABLES

Table 1.1:	Summary of Infrastructure Tax Credit Scheme (Kina Millions).
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 1.5	Tax savings from personal income tax cuts from 1 January 2008

Table 1.1: Summary of Infrastructure Tax Credit Scheme (Kina Millions)

	Actual 2004	Actual 2005	Est. 2006	Est. 2007	Proj 2008
Total Mining and Petroleum Taxes Paid	634.3	1076.8	1946.5	2362	1746.4
Mining and Petroleum Taxes Paid by companies involved in ITC	634.3	1076.8	1946.5	2362	1746.4
Total ITC Claimed and Allowed	98.6	71.6	89.6	71.2	80.4
Expenditure incurred on Approved ITC Projects	34.7	20.3	89.6	71.2	80.4
Tax Credit Claimed as Percentage of Taxes Paid by Companies Subject to ITC	15.6	6.7	5.1	6.6	4.6
Excess Credits Carried Forward (from prior years)	na	na	na	na	na

Notes: 1. A total tax expenditure of K71.2 million is expected to be incurred on approved ITC Projects in 2007. Detailed information on this expenditure is not yet available.

2. Tax Credit expenditures for 2006 are based on company tax returns assessed by October 2006.

3. ITC is abbreviated for Infrastructure Tax Credit.

4. i.e not available

Source: Department of National Planning & Monitoring and Internal Revenue Commission

Table 1.2: Incentives Under the Income Tax Act Resulting in Permanent Loss of Revenue (Kina)

Section	Description	2003 Number	Amount	2004 Number	Amount	2005 Number	Amount	2006 Number	Amount	Grand Total Amount
25	Institutions and Hospitals	2	3,075	2	11,950	3	17,514	1	346	32,885
25A	Charitable Institutions	5	8,046,230	6	10,770,469	5	7,152,179	2	3,901,519	29,870,397
27	Non-Profit Bodies	5	772,493	4	84,667			1	367,710	1,224,870
35(1)	Exempt interest	14	3,936,108	13	668,579	16	1,392,626	6	509,727	6,507,040
35A	Fishing Operations			1	609,560					609,560
45B	Export Sales Exemptions	2	438,121	3	792,122	4	14,896,443	5	14,637,002	30,763,688
45I	Rural Development	5	10,255,436	3	10,515,720	1	766,789	2	369,492	21,907,437
45N	Bougainville Incentive	4	1,339,688	1	128,263					1,467,951
46AA	Rabaul Incentive	1	46,606	1	121,517					168,123
69A	Gifts to Sporting Bodies	6	53,092	5	24,235			1	2,700	80,027
69C	Gifts to Law, Order and Justice	1	250			1	261			511
69E	Gifts to Charities	4	18,588	3	122,481	3	8,346	1	450	149,865
69I	Gifts to National Day Celebrations							1	10,000	10,000
69J	Gifts to PNGSC 2000 Olympics									-
70A	Deduction for Education Expenses	49	1,034,200	21	528,172	22	404,107	13	149,090	2,115,569
72A	Double Deduction - Training	36	3,446,608	19	1,083,754	21	2,062,394	14	811,149	7,403,905
72C	Double Deduction - Export Market Development	5	1,236,070	2	54,069	3	88,889	4	142,233	1,521,261
95	Research and Development - 150%									-
97A	Primary Production Development Expenditure	2	12,471,600	1	1,854,252	1	2,787,118	1	4,149,637	21,262,607
97B	Agriculture Extension Services - 150%									-
CH 119	Pioneer Industries									-
		141	43,098,165	85	27,369,810	80	29,576,666	52	25,051,055	125,095,696

Note: Number means the number of tax payers claiming the concessions
A dash means no exemptions were recorded.

Source: Internal Revenue Commission

Table 1.3: Incentives Under the Income Tax Act Involving Deferral of Income Tax (Kina)

Section	Description	2003 Number	Amount	2004 Number	Amount	2005 Number	Amount	2006 Number	Amount	Grand Total Amount
68A	Solar Heating									-
73(3)	Depreciation 20% loading	1	32,629	2	19,978	1	265,428	5	231,726	549,761
73(6)	Depreciation non-oil fired plant	1	37,434							37,434
73(7)	Depreciation - industrial plant	8	19,659,536	4	5,661,906	5	5,028,452	4	2,431,571	32,781,465
73(9)	Depreciation - Primary Production	4	13,831,735	2	1,192,744	2	763,333	1	218,446	16,006,258
		14	33,561,334	8	6,874,628	8	6,057,213	10	2,881,743	49,374,918

Note: Number means the number of tax payers claiming the concessions

A dash means no exemptions were recorded.

Source: Internal Revenue Commission

Table 1.4: Exemptions Under the Stamp Duties Act

Schedule 1	Description of Exemptions	2006 Number	Amount	2007 Number	Amount	Grand Total Amount
Item 5	First Time Home Buyers Exemption	765	1,846,833	448	928,773	2,775,606
						-
Item 5	Charities	5	126,540	6	163,012	289,552
						-
Item 8	Wills	2	24,040			24,040
						-
Item 16	Transfers of marketable securities	1	9			9
						-
						-
Section 6	Purchase of Property by State Instrumentalities	4	41,640	7	14,437	56,077
						-
						-
		777	2,039,062	461	1,106,222	3,145,284

Note: Number means number of transactions
 2006 Figures are from January to December 2006
 2007 Figures are from January to July 2007
 A dash means no exemptions were granted

Source: Internal Revenue Commission

Table 1.5 Tax Savings from Personal Income tax cuts from 1 January 2008

	Taxpayer without dependent		Taxpayer with one dependent		Taxpayer with two dependents		Taxpayer with three dependents	
Income (kina/year)	Tax saving (kina/fortnight)	Tax Saving (per cent)	Tax saving (kina/fortnight)	Tax Saving (per cent)	Tax saving (kina/fortnight)	Tax Saving (per cent)	Tax saving (kina/fortnight)	Tax Saving (per cent)
10,000	7.31	22.4	6.23	22.4	5.50	22.4	4.77	22.4
15,000	13.08	16.2	11.12	16.2	9.81	16.2	8.50	16.2
20,000	16.54	12.5	16.54	14.3	16.54	15.9	16.54	17.9
25,000	16.54	8.7	16.54	9.6	16.54	10.2	16.54	11.0
30,000	16.54	6.7	16.54	7.2	16.54	7.5	16.54	8.0
35,000	16.54	5.3	16.54	5.7	16.54	5.9	16.54	6.1
40,000	16.54	4.4	16.54	4.6	16.54	4.8	16.54	4.9
45,000	16.54	3.7	16.54	3.9	16.54	4.0	16.54	4.1
50,000	16.54	3.2	16.54	3.3	16.54	3.4	16.54	3.5
55,000	16.54	2.9	16.54	2.9	16.54	3.0	16.54	3.1
60,000	16.54	2.6	16.54	2.6	16.54	2.7	16.54	2.7
65,000	16.54	2.3	16.54	2.4	16.54	2.4	16.54	2.5
70,000	16.54	2.1	16.54	2.2	16.54	2.2	16.54	2.2
75,000	16.54	1.9	16.54	2.0	16.54	2.0	16.54	2.0
80,000	16.54	1.8	16.54	1.8	16.54	1.8	16.54	1.8
85,000	16.54	1.6	16.54	1.7	16.54	1.7	16.54	1.7
90,000	16.54	1.5	16.54	1.5	16.54	1.6	16.54	1.6
95,000	16.54	1.4	16.54	1.4	16.54	1.5	16.54	1.5
100,000	16.54	1.3	16.54	1.4	16.54	1.4	16.54	1.4

Source: Department of Treasury

APPENDIX 2: GRANTS AND TRANSFERS TO PROVINCES

Table 2.1: National Governments Grants to Provincial and Local Level Governments (Kina Thousands)

Table 2.2: Grants, Transfers and other resources to Provincial Governments (Kina Thousands)

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	Block	Health Function	Education Function	Transport Function	Village Court Function	Derivation 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	7,855.5	23,138.7	210.0	787.1	156.8	32,148.1	282.0	481.8	780.0	784.7	127.6	618.1	1,620.9			4,695.1	36,843.2
Gulf	6,948.0	10,132.5	171.0	550.0	120.7	17,922.2	693.9	756.0	1,072.9	319.8	49.0	532.8	909.5			4,333.9	22,256.1
Central	9,400.0	24,472.1	273.9	962.5	267.1	35,375.6	809.5	628.7	1,116.2	612.4	153.9	257.6	1,314.5	138.2		5,031.0	40,406.6
NCD	0.0	0.0	0.0	0.0	97.4	97.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2,860.5		2,860.5	2,957.9
Milne Bay	9,000.0	23,289.1	300.0	914.9	284.3	33,788.3	839.4	681.0	1,005.1	756.0	76.2	556.0	1,614.4			5,528.1	39,316.4
Oro	6,806.6	11,056.1	294.4	756.5	124.0	19,037.6	456.3	480.1	789.8	441.1	42.5	773.4	1,255.0			4,238.2	23,275.8
S. Highlands	14,644.1	31,531.0	393.3	700.0	501.3	47,769.7	1,550.0	2,050.0	1,919.5	1,279.7	257.3	46.7	4,251.6			11,354.8	59,124.5
Enga	12,058.6	20,911.8	220.9	839.7	512.8	34,543.8	970.5	867.3	929.3	1,033.7	153.3	89.2	2,099.5			6,142.8	40,686.6
W. Highlands	8,672.5	29,821.7	410.0	873.8	387.8	40,165.8	911.6	1,269.4	1,343.9	2,204.9	274.3	1,199.7	3,443.3			10,647.1	50,812.9
Simbu	7,515.4	24,765.7	204.8	440.1	341.2	33,267.2	1,100.0	720.8	1,416.5	748.1	150.2	144.6	1,924.0			6,204.2	39,471.4
E. Highlands	10,000.0	27,021.4	617.4	909.3	392.3	38,940.4	1,800.0	996.6	1,886.5	1,058.2	153.0	1,025.5	3,374.3			10,294.1	49,234.5
Morobe	10,758.1	48,033.5	479.0	878.9	321.2	60,470.7	1,820.5	722.3	1,644.0	3,043.3	113.7	373.4	5,177.2			12,894.4	73,365.1
Madang	6,902.2	23,837.9	97.9	732.4	274.8	31,845.2	1,409.5	952.7	1,600.0	988.4	78.3	760.2	2,981.3			8,770.4	40,615.6
East Sepik	10,000.0	22,902.1	200.0	914.9	431.9	34,448.9	1,290.0	1,008.3	1,586.1	1,108.3	167.3	850.6	2,733.6			8,744.2	43,193.1
Sandaun	7,567.7	19,351.4	359.5	900.0	153.6	28,332.2	800.0	600.2	955.0	744.1	67.1	382.1	1,487.3			5,035.8	33,368.0
Manus	4,169.0	8,284.5	168.7	483.0	154.9	13,260.1	135.8	421.9	387.2	313.6	73.3	101.5	389.5			1,822.8	15,082.9
New Ireland	7,173.2	15,167.9	260.8	700.4	169.4	23,471.7	369.4	206.6	845.0	150.0	51.7	547.3	997.8			3,167.8	26,639.5
E. New Britain	9,788.2	32,000.0	230.0	908.5	179.7	43,106.4	162.2	929.1	1,269.4	708.3	70.6	1,527.3	1,895.0			6,561.9	49,668.3
W. New Britain	6,954.7	20,657.4	157.9	914.9	167.4	28,852.3	122.0	767.9	1,167.9	435.7	165.3	4,330.6	1,515.5			8,504.9	37,357.2
Bougainville	9,522.7	25,331.0	238.2	835.6		35,927.5									18,072.5	18,072.5	54,000.0
Total	165,736.5	441,705.8	5,287.7	15,002.5	5,038.6	632,771.1	15,522.6	14,540.7	21,714.3	16,730.3	2,224.6	14,116.6	38,984.2	2,998.7	18,072.5	144,904.5	777,675.6

Table 2.2: Grants, transfers and other resources to Provincial Governments (Kina Thousands)

	Total Grants and Transfers from the			Non-Grant Tax Transfers				Total
	Recurrent Budget	Development Budget	Sub Total National Government	GST (1)	Mining and Petroleum Royalties (2)	Own Source Revenues (3)	Sub Total Non-Grant	
Western	36,843.2	22,298.0	59,141.2	4,033.1	43,806.8	48,440.6	96,280.5	155,421.7
Gulf	22,256.1	5,170.0	27,426.1	536.8		5,354.1	5,890.9	33,317.0
Central	40,406.6	2,850.0	43,256.6	1,347.5	491.0	4,471.2	6,309.7	49,566.3
NCD	2,957.9	2,000.0	4,957.9	107,749.7		11,514.1	119,263.7	124,221.6
Milne Bay	39,316.4	2,250.0	41,566.4	2,313.0		935.4	3,248.4	44,814.8
Oro	23,275.8	1,750.0	25,025.8	1,425.9		285.5	1,711.4	26,737.2
S. Highlands	59,124.5	15,832.0	74,956.5	1,512.2	29,346.9	6,486.8	37,345.8	112,302.3
Enga	40,686.6	9,000.0	49,686.6	3,339.6	14,505.9	3,023.6	20,869.1	70,555.7
W. Highlands	50,812.9	3,000.0	53,812.9	9,872.2		2,132.3	12,004.5	65,817.4
Simbu	39,471.4	2,750.0	42,221.4	1,085.3		345.9	1,431.3	43,652.7
E. Highlands	49,234.5	4,250.0	53,484.5	9,780.5	642.8	1,453.8	11,877.1	65,361.6
Morobe	73,365.1	3,500.0	76,865.1	30,722.2		12,217.4	42,939.6	119,804.7
Madang	40,615.6	3,750.0	44,365.6	10,705.4		1,153.1	11,858.4	56,224.0
East Sepik	43,193.1	2,750.0	45,943.1	3,158.2		2,102.8	5,261.0	51,204.1
Sandaun	33,368.0	2,250.0	35,618.0	1,186.3		1,278.6	2,464.9	38,082.9
Manus	15,082.9	1,500.0	16,582.9	1,156.6		440.8	1,597.3	18,180.2
New Ireland	26,639.5	9,630.0	36,269.5	3,980.6	17,531.5	710.3	22,222.4	58,491.9
E. New Britain	49,668.3	3,750.0	53,418.3	9,720.2		3,633.5	13,353.7	66,772.0
W. New Britain	37,357.2	1,750.0	39,107.2	4,589.4		3,538.7	8,128.1	47,235.3
Bougainville	54,000.0	17,000.0	71,000.0	758.1		3,532.2	4,290.3	75,290.3
Total	777,675.6	117,030.0	894,705.6	208,972.7	106,324.9	113,050.7	428,348.3	1,323,053.9

(1) Distribution calculated on the basis of 60% of last available annual actual net inland GST collections from that province, or the 2006 distribution (whichever is the higher). This amount is then indexed by the Minister's estimate of inflation.

(2) NEFC estimates, based on 2008 estimates of mining & petroleum production and prices from Treasury.

(3) 2006 actual data in 2008 Kina terms. Own source revenue data from the Department of Finance (PNG Government Accounting System data on internal revenues) and the Mineral Resources Development Company (for data dividends received from equity shares in mining and petroleum resource projects). Excludes revenue carried over from former years, GST and mining and petroleum royalties.

APPENDIX 3: ECONOMIC AND FISCAL DATA TABLES

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TABLE 1: GROSS DOMESTIC PRODUCT BY ECONOMIC ACTIVITY AT CURRENT
AND CONSTANT PRICES (Kina Million)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Prelim.	Prelim.	Est.	Est.	Proj	Proj	Proj	Proj	Proj	Proj
Agriculture, Forestry and Fishing										
nominal	4819.4	4550.8	5684.0	5822.9	6342.9	6989.0	7447.6	7916.7	8387.5	8892.7
deflator	164.6	148.6	182.3	185.5	194.8	204.6	208.8	213.6	218.0	222.9
real	2927.2	3062.1	3117.6	3138.7	3255.6	3415.9	3567.2	3706.6	3847.8	3989.7
rate of real growth	5.0	4.6	1.8	0.7	3.7	4.9	4.4	3.9	3.8	3.7
Oil and Gas Extraction										
nominal	853.0	738.4	1651.3	1977.3	2037.8	1694.7	1471.4	1235.6	1064.3	950.6
deflator	317.8	300.5	591.8	710.2	725.7	657.4	655.0	638.2	631.1	626.3
real	268.4	245.7	279.0	278.4	280.8	257.8	224.7	193.6	168.6	151.8
rate of real growth	-1.5	-8.5	13.6	-0.2	0.9	-8.2	-12.9	-13.8	-12.9	-10.0
Mining and Quarrying										
nominal	1398.8	1652.7	1903.9	2708.3	2889.9	2867.9	2883.1	3123.9	3208.9	2966.6
deflator	199.6	227.7	257.1	396.7	402.5	349.8	316.7	295.1	283.1	276.0
real	700.7	725.9	740.7	680.7	718.0	819.8	910.3	1058.6	1133.3	1074.9
rate of real growth	4.6	3.6	2.0	-8.1	5.5	14.2	11.0	16.3	7.1	-5.2
Manufacturing										
nominal	820.8	848.3	942.5	999.5	1070.6	1180.3	1264.3	1354.3	1450.8	1554.1
deflator	139.8	141.3	142.7	144.1	148.5	157.4	162.1	166.9	172.0	177.1
real	587.1	600.4	660.4	693.5	721.2	750.0	780.1	811.3	843.7	877.5
rate of real growth	4.8	2.3	10.0	5.0	4.0	4.0	4.0	4.0	4.0	4.0
Electricity, gas and water										
nominal	228.7	263.7	284.4	301.7	320.1	352.8	381.6	412.7	446.3	482.7
deflator	189.0	209.0	219.4	226.0	232.8	246.7	254.1	261.8	269.6	277.7
real	121.0	126.2	129.6	133.5	137.5	143.0	150.2	157.7	165.5	173.8
rate of real growth	13.4	4.3	2.7	3.0	3.0	4.0	5.0	5.0	5.0	5.0
Construction										
nominal	1128.9	1177.0	1245.8	1437.2	1720.3	2060.6	2271.0	2474.8	2696.9	2888.9
deflator	133.0	134.4	135.8	139.8	146.8	155.6	160.3	165.1	170.1	175.2
real	848.7	875.7	917.7	1027.9	1171.8	1324.1	1416.8	1499.0	1585.9	1649.3
rate of real growth	5.4	3.2	4.8	12.0	14.0	13.0	7.0	5.8	5.8	4.0
Wholesale and retail trade										
nominal	849.9	890.5	944.6	1021.3	1136.1	1264.5	1348.1	1437.1	1532.0	1633.2
deflator	157.6	160.0	163.2	166.5	171.5	181.8	187.3	192.9	198.7	204.6
real	539.4	556.4	578.7	613.4	662.4	695.6	719.9	745.1	771.2	798.2
rate of real growth	2.6	3.2	4.0	6.0	8.0	5.0	3.5	3.5	3.5	3.5
Transport, storage and communication										
nominal	293.9	304.7	317.0	326.2	396.3	454.3	491.3	526.3	563.8	603.9
deflator	140.1	141.5	142.9	140.1	126.1	113.5	116.9	120.4	124.0	127.7
real	209.8	215.3	221.8	232.8	314.3	400.4	420.4	437.2	454.7	472.9
rate of real growth	2.1	2.6	3.0	5.0	35.0	27.4	5.0	4.0	4.0	4.0
Finance, real estate and business services										
nominal	422.9	415.2	449.0	501.8	542.7	598.3	640.9	686.5	735.4	787.8
deflator	135.0	137.3	141.4	145.6	150.0	159.0	163.8	168.7	173.7	178.9
real	313.3	302.5	317.6	344.6	361.9	376.3	391.4	407.0	423.3	440.3
rate of real growth	-3.4	-3.4	5.0	8.5	5.0	4.0	4.0	4.0	4.0	4.0
Community, social and personal services										
nominal	1403.1	1395.0	1427.2	1521.4	1629.7	1762.1	1851.2	1944.9	2043.3	2146.7
deflator	123.9	126.2	126.9	132.0	136.0	144.1	148.5	152.9	157.5	162.2
real	1132.9	1105.5	1124.3	1152.4	1198.5	1222.5	1246.9	1271.9	1297.3	1323.2
rate of real growth	-3.5	-2.4	1.7	2.5	4.0	2.0	2.0	2.0	2.0	2.0
TOTAL GDP*										
nominal	12567.3	12652.1	15263.2	17050.8	18550.9	19724.1	20587.1	21688.5	22726.9	23546.9
rate of nominal growth	7.8	0.7	20.6	11.7	8.8	6.3	4.4	5.3	4.8	3.6
deflator	159.2	156.0	182.1	198.3	203.2	202.6	202.2	203.5	205.2	207.4
real	7895.7	8110.5	8383.3	8597.6	9131.5	9735.2	10181.3	10658.5	11076.8	11354.9
rate of real growth	2.2	2.7	3.4	2.6	6.2	6.6	4.6	4.7	3.9	2.5
Total non-mining GDP										
nominal	10315.5	10261.0	11708.0	12365.1	13623.2	15161.5	16232.7	17329.0	18453.7	19629.7
rate of nominal growth	8.5	-0.5	14.1	5.6	10.2	11.3	7.1	6.8	6.5	6.4
deflator	148.9	143.7	159.0	161.9	167.5	175.1	179.4	184.2	188.8	193.8
real	6926.6	7138.9	7363.7	7638.4	8132.7	8657.5	9046.4	9406.3	9774.9	10128.3
rate of real growth	2.1	3.1	3.1	3.7	6.5	6.5	4.5	4.0	3.9	3.6

*Sum of industries less imputed bank service charge, plus import duties, less subsidies.

Source: Dept. of Treasury, 2003 - 2012: estimates and projections

TABLE 2: CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT
(Percentage points)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Prelim.	Prelim.	Est	Est	Est	Proj	Proj	Proj	Proj	Proj
Agriculture, Forestry and Fishing	1.8	1.7	0.7	0.3	1.4	1.8	1.6	1.4	1.3	1.3
Oil and Gas Extraction	-0.1	-0.3	0.4	0.0	0.0	-0.3	-0.3	-0.3	-0.2	-0.2
Mining and Quarrying	0.4	0.3	0.2	-0.7	0.4	1.1	0.9	1.5	0.7	-0.5
Manufacturing	0.4	0.2	0.7	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Electricity, gas and water	0.2	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Construction	0.6	0.3	0.5	1.3	1.7	1.7	1.0	0.8	0.8	0.6
Wholesale and retail trade	0.2	0.2	0.3	0.4	0.6	0.4	0.3	0.2	0.2	0.2
Transport, storage and communication	0.1	0.1	0.1	0.1	0.9	0.9	0.2	0.2	0.2	0.2
Finance, real estate and business services	-0.1	-0.1	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Community, social and personal services	-0.5	-0.3	0.2	0.3	0.5	0.3	0.3	0.2	0.2	0.2
TOTAL GDP	2.2	2.7	3.4	2.6	6.2	6.6	4.6	4.7	3.9	2.5
Total Non-mining GDP	2.1	3.1	3.1	3.7	6.5	6.5	4.5	4.0	3.9	3.6

*Sum of industries less imputed bank service charge, plus import duties, less subsidies.

Source: Dept. of Treasury; 2003 - 2012 estimates and projections.

TABLE 3: PRICES OF MAIN EXPORT COMMODITIES
 (Kina per tonne fob, unless otherwise specified)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Actual	Actual	Actual	Actual	Proj	Proj	Proj	Proj	Proj	Proj
AGRICULTURE										
Copra	776	896	776	654	654	597	571	545	530	519
Cocoa	6395	5253	4495	4645	4565	4553	4582	4582	4582	4582
Coffee	4339	4505	6533	6444	6297	5713	5441	5169	4897	4897
Palm Oil	1289	1294	1132	1181	1273	1091	1077	1064	1064	1091
Rubber	2929	3632	3750	5409	5254	4903	4631	4358	4086	4086
Tea	2924	2827	2928	3212	2714	2622	2609	2596	2584	2558
Copra Oil	1413	1796	1722	1455	1456	1330	1272	1215	1180	1157
Logs (K/m ³)	183	177	177	186	206	218	222	225	227	228
MINERALS										
Gold (US\$/oz)	363	409	445	604	662	662	662	662	662	662
Copper (US\$/lb)	0.81	1.30	1.67	3.05	3.28	2.45	1.84	1.43	1.22	1.18
Oil (Kutubu Crude: US\$/barrel)	27.4	42.1	53.4	64.3	67.3	61.9	61.7	60.1	59.4	59.0

Source: Actuals from BPNG. Projections from IMF and Dept. of Treasury.

TABLE 4: VOLUME OF MAIN EXPORT COMMODITIES
('000 tonnes, unless otherwise specified)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Actual	Actual	Actual	Actual	Proj	Proj	Proj	Proj	Proj	Proj
AGRICULTURE										
Copra	8.4	19.2	22.3	12.7	23.2	23.2	23.2	23.2	28.3	34.3
Cocoa	40.3	41.5	44.2	44.0	44.8	47.0	48.5	50.9	52.9	54.0
Coffee	68.8	63.0	72.1	52.3	56.2	70.3	75.7	76.8	73.5	88.2
Palm Oil	326.9	339.0	345.8	362.3	382.6	401.0	436.0	459.7	482.7	506.8
Rubber	4.2	3.8	4.8	4.4	4.5	4.7	4.8	5.0	5.2	5.4
Tea	6.6	8.1	6.9	6.6	7.1	7.2	7.3	7.6	7.9	7.8
Copra Oil	47.7	45.1	54.4	41.5	54.1	54.1	54.1	54.1	64.9	80.2
Logs	2016.0	2012.1	2282.4	2638.3	2825.6	2715.9	2651.7	2531.2	2403.4	2217.7
MINERAL										
Gold (tonnes)	68.4	67.3	70.5	55.8	66.6	78.3	84.7	83.5	85.7	77.7
Copper	230.6	173.9	226.1	216.7	242.6	238.6	236.5	236.5	236.5	236.5
Oil (million barrels)	15.0	12.6	13.3	14.4	14.8	13.4	11.3	9.5	7.9	6.9

Source: Actuals from BPNG. Projections from Dept. of Treasury.

TABLE 5: VALUE OF MAIN EXPORT COMMODITIES
(Kina Million)

	2003 Actual	2004 Actual	2005 Actual	2006 Actual	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj
AGRICULTURE, FORESTRY, FISHERIES										
Copra	6.5	17.2	17.3	8.3	15.2	13.9	13.3	12.7	15.0	17.8
Copra Oil	67.4	81.0	93.7	60.4	78.8	72.0	68.8	65.7	76.5	92.8
Cocoa	257.7	218.0	198.7	204.4	204.6	214.2	222.0	233.1	242.5	247.3
Coffee	298.5	283.8	471.0	337.0	353.9	401.6	411.9	397.2	359.9	432.0
Palm Oil	421.3	438.7	391.4	427.9	487.2	437.4	469.7	488.9	513.4	552.9
Rubber	12.3	13.8	18.0	23.8	23.8	22.9	22.3	21.6	21.0	21.9
Tea	19.3	22.9	20.2	21.2	19.4	18.8	19.0	19.6	20.3	20.0
Other Agriculture (a)	115.2	80.0	-1.6	30.6	31.9	33.1	34.5	35.9	37.3	38.8
Forest Products	416.0	459.5	476.3	520.3	714.8	708.8	696.7	669.3	625.6	582.9
Marine Products	125.3	58.2	69.4	89.1	95.3	105.3	114.3	123.7	133.9	144.9
Total Agricultural, Forestry, Fishing Exports	1739.5	1673.1	1754.4	1723.0	2024.8	2028.0	2072.4	2067.7	2045.3	2151.3
MINERAL										
Gold	2811.2	2779.5	2834.1	3069.4	4056.5	4694.7	5081.0	5009.5	5139.0	4657.0
Copper	1415.0	1544.2	2497.7	4329.5	5089.4	3680.9	2736.2	2128.1	1824.1	1763.3
Silver	31.9	31.6	37.0	39.3	49.8	45.4	38.3	38.3	38.3	38.3
Oil	1631.9	1652.2	2283.1	2967.3	3106.0	2548.1	2155.6	1750.8	1453.8	1257.6
Refined Petroleum Products		202.8	496.8	252.1	257.6	238.0	241.9	240.4	242.5	245.4
Other	31.9	31.6	37.0	39.3	49.8	45.4	38.3	1026.2	1288.8	1202.0
Total Mineral Exports	5890.0	6210.3	8148.7	10657.6	12559.2	11207.1	10252.9	10155.1	9948.1	9125.3
TOTAL EXPORT VALUE	7629.5	7883.4	9903.1	12380.7	14584.0	13235.1	12325.3	12222.8	11993.4	11276.6

Source: Actuals from BPNG. Projections from Dept. of Treasury.
(a) Includes Oil Palm by-products, canned tuna and vanilla.

TABLE 6: SUMMARY OF THE BALANCE OF PAYMENTS
(Kina Million)

	2003 Actual	2004 Actual	2005 Actual	2006 Actual	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj
CURRENT ACCOUNT BALANCE	496	393	1887	1255	802	806	391	581	416	93
Balance of Trade in Goods and Services	1348	969	2754	3113	2160	2313	1597	1570	1241	692
<i>Goods Balance</i>	<i>3611</i>	<i>3530</i>	<i>5437</i>	<i>6668</i>	<i>6874</i>	<i>6159</i>	<i>5234</i>	<i>5056</i>	<i>4802</i>	<i>4211</i>
Credit (Exports)	7842	8233	10168	12752	14584	13235	12325	12223	11993	11277
Debit (Imports)	-4231	-4703	-4731	-6084	-7710	-7076	-7091	-7167	-7191	-7065
<i>Services Balance</i>	<i>-2263</i>	<i>-2561</i>	<i>-2683</i>	<i>-3554</i>	<i>-4714</i>	<i>-3846</i>	<i>-3637</i>	<i>-3486</i>	<i>-3561</i>	<i>-3519</i>
Services Credit	829	656	938	965	1047	1106	1152	1238	1299	1305
Services Debit	-3092	-3217	-3621	-4519	-5761	-4952	-4790	-4724	-4860	-4825
Income Balance	-1699	-1406	-1670	-2462	-2193	-2438	-2212	-2052	-1953	-1806
Income Credit	58	64	81	215	231	256	275	303	323	327
Income Debit	-1757	-1470	-1751	-2677	-2424	-2694	-2488	-2355	-2276	-2132
Transfers Balance	847	830	803	604	835	931	1007	1063	1128	1206
Transfers Credit	1137	1080	1093	1000	1325	1393	1492	1580	1672	1763
Transfers Debit	-290	-250	-290	-396	-490	-463	-485	-517	-543	-557
CAPITAL AND FINANCIAL ACCOUNT(a)	-549	-410	-1886	-1239	-802	-806	-391	-581	-416	-93
NET ERRORS AND OMISSIONS	53	17	-1	-16	0	0	0	0	0	0
Current account balance as percentage of Gross Domestic Product (GDP)	3.9	3.1	12.4	7.4	4.3	4.1	1.9	2.7	1.8	0.4

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)

	2001	2002	2003	2004	2005	2006	2007
	Annual	Annual	Annual	Annual	Annual	Annual	June Qtr
Retail	100.6	97.9	96.9	93.1	93.7	97.7	113.6
Wholesale	102.7	103.3	113.3	123.8	130.7	145.6	154.4
Manufacturing	99.5	104.1	110.9	117.7	127.5	132.6	139.7
Building and Construction	92.9	99.0	124.1	107.9	98.4	118.9	142.5
Transportation	99.4	106.3	106.1	106.8	106.1	108.2	117.0
Agriculture, Forestry, Fisheries	102.2	103.9	114.1	112.9	112.9	123.3	143.9
Financial and Business	100.5	99.1	100.8	104.7	105.7	112.4	112.0
TOTAL NON-MINERAL	100.6	102.2	108.5	109.2	111.0	119.1	131.9
Mineral	96.9	98.8	97.6	95.6	101.5	111.1	119.7

Source: BPNG.

TABLE 8: CENTRAL GOVERNMENT REVENUE AND GRANTS
(Kina Million)

	2003 Actual	2004 Actual	2005 Actual	2006 Actual	2007 Est	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj
TAX REVENUE	2677.9	3220.1	3744.0	4944.8	5693.4	5516.8	4843.6	4804.2	4911.3	4999.4
TAX ON INCOME AND PROFITS	1786.6	2223.4	2770.8	3823.5	4386.9	4142.0	3403.1	3281.5	3297.0	3305.4
Personal Income Tax	758.4	826.5	841.0	907.0	994.1	1053.7	1114.9	1208.0	1307.5	1414.0
Company tax	334.5	436.7	516.5	550.6	633.2	699.7	743.8	794.0	845.6	899.5
DWT	117.2	123.2	154.7	200.9	183.3	195.5	193.7	195.2	193.0	179.8
Mining and Petroleum Taxes	396.5	634.3	1076.8	1946.5	2362.0	2011.8	1158.7	880.8	735.3	583.8
Interest withholding tax	41.4	33.3	17.9	22.1	19.4	21.4	25.7	25.7	25.7	25.7
Other Direct	55.3	78.6	72.1	92.4	95.2	73.4	72.6	77.5	82.5	87.8
Gaming Tax	83.3	90.7	91.9	104.0	99.6	86.5	93.8	100.4	107.4	115.0
DOM. TAXES ON GOODS AND SERVICES	596.0	620.8	657.3	784.3	940.3	987.3	1032.7	1097.8	1174.2	1242.1
Excise	174.7	203.1	255.9	324.1	335.8	368.3	394.4	421.0	448.3	476.9
GST	311.8	315.7	326.2	401.1	554.3	600.8	634.9	673.2	722.0	761.1
Mining Levy	101.8	101.3	73.1	56.1	48.0	15.0	0.0	0.0	0.0	0.0
Other Indirect	7.8	0.7	2.1	3.0	2.2	3.2	3.4	3.6	3.9	4.1
TAXES ON INTERNATIONAL TRADE	295.3	375.9	315.9	337.0	366.3	387.4	407.8	424.9	440.1	451.9
Import Duty	73.7	151.1	101.1	90.4	124.2	132.7	142.0	151.6	161.5	171.8
Export Duty	111.8	101.5	136.3	162.6	152.6	155.2	159.2	159.5	157.5	151.3
Excise Duty on Imports	109.8	123.3	78.5	84.0	89.4	99.5	106.6	113.8	121.2	128.9
NON TAX REVENUE	239.2	245.1	279.3	428.8	459.8	487.5	366.6	291.1	247.2	239.4
PROPERTY INCOME	159.7	164.7	188.2	339.3	375.2	388.3	263.2	184.3	136.8	125.4
Dividends	85.7	105.0	50.0	68.1	73.5	128.5	108.5	88.5	73.5	73.5
Mining and Petroleum Dividends	74.0	59.7	138.2	271.2	301.7	259.8	154.7	95.8	63.3	51.9
INTEREST AND FEES FROM LENDING	4.3	2.8	0.5	0.6	2.6	5.0	5.0	5.0	5.0	5.0
OTHER NON TAX REVENUE	75.2	77.6	90.7	88.9	82.0	94.2	98.4	101.9	105.4	109.0
ASSET SALES	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL REVENUE	2917.1	3465.2	4023.4	5373.6	6153.2	6004.3	5210.2	5095.4	5158.4	5238.8
% of GDP	23.2%	27.4%	26.4%	31.5%	33.2%	30.4%	25.3%	23.5%	22.7%	22.2%
INFRASTRUCTURE TAX CREDITS	40.0	34.7	20.3	23.3	33.0	73.7	42.4	32.3	26.9	21.4
GRANTS	693.0	849.7	1283.1	914.6	1013.4	1123.7	1240.8	1308.7	1382.0	1461.2
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	693.0	849.7	1283.1	914.6	1013.4	1123.7	1240.8	1308.7	1382.0	1461.2
TOTAL REVENUE AND GRANTS	3650.1	4349.6	5326.8	6311.6	7199.6	7201.7	6493.4	6436.4	6567.3	6721.4
% of GDP	29.0%	34.4%	34.9%	37.0%	38.8%	36.5%	31.5%	29.7%	28.9%	28.5%
PRINCIPAL RECEIPTS FROM LENDING	9.6	10.4	2.7	4.2	6.0	4.0	4.0	4.0	4.0	4.0
GROSS BORROWING	813.7	1433.7	1665.8	1268.2	1620.0	1794.0	1460.5	1085.4	1764.1	1433.2
ASSET SALES	40.0	25.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL RECEIPTS	4513.4	5818.7	6995.3	7584.0	8825.5	8999.7	7957.9	7525.7	8335.4	8158.6
% of GDP	35.9%	46.0%	45.8%	44.5%	47.6%	45.6%	38.7%	34.7%	36.7%	34.6%

Source: Department of Treasury.

TABLE 9: CENTRAL GOVERNMENT EXPENDITURE
(Kina Million)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Actual	Actual	Actual	Actual	Est	Proj	Proj	Proj	Proj	Proj
RECURRENT BUDGET										
NATIONAL DEPARTMENTS	1192.4	1555.1	1833.1	1665.9	2032.1	2262.3	2379.8	2528.4	2724.9	2915.1
Personal Emoluments (a)	618.0	682.2	690.5	698.0	848.2	932.1	1029.5	1112.3	1147.9	1185.3
Goods and Services	574.4	872.9	1142.6	967.9	1183.9	1330.2	1350.3	1416.1	1577.0	1729.7
General Goods and Services	489.9	534.9	904.0	786.6	919.3	1079.3	1097.9	1162.4	1321.8	1473.1
Education Subsidies	29.9	39.5	40.9	42.4	143.0	143.0	144.5	145.8	147.3	148.7
Pre-March 2003 Arrears Payments	20.6	141.8	36.2	33.9	0.0	0.0	0.0	0.0	0.0	0.0
Structural Adjustment Payments	9.7	66.7	104.5	30.3	69.6	55.9	55.9	55.9	55.9	55.9
Court Orders	24.2	90.0	57.0	74.7	52.0	52.0	52.0	52.0	52.0	52.0
PROVINCIAL DEPARTMENTS	563.3	656.0	632.5	765.1	696.6	723.7	799.3	892.5	954.2	1022.6
Personal Emoluments	482.9	580.2	543.4	662.5	576.0	596.8	628.8	695.9	733.2	772.6
Staffing Grants	160.7	183.0	162.5	191.3	156.4	166.3	172.1	187.2	193.6	200.3
Teachers' Salaries	322.2	397.2	380.9	471.2	419.6	430.5	456.7	508.7	539.6	572.3
Goods and Other Services	53.4	54.0	54.6	65.1	63.4	65.9	69.1	72.3	75.6	79.1
Administration / Block Grants	34.0	17.5	11.8	21.3	14.2	15.5	16.1	16.5	17.1	17.6
Health Function Grant	0.0	9.1	11.8	11.5	13.4	14.5	15.4	16.3	17.3	18.3
Education Subsidies / Function Grant	11.0	16.9	19.8	20.6	21.6	21.7	23.0	24.4	25.8	27.3
Derivation Grants	8.5	10.5	11.2	11.7	14.2	14.1	14.6	15.0	15.5	16.0
Conditional Grants	26.9	21.8	34.5	37.5	57.2	60.9	64.7	68.4	72.4	76.6
Provincial Infr / Transp Maint Grants	13.9	12.5	12.7	14.4	15.3	16.7	17.8	18.8	19.9	21.0
Local & Village Services / Rural LLG	8.1	3.8	15.4	16.5	36.7	30.9	32.8	34.7	36.7	38.9
Town and Urban Services	4.8	5.6	6.4	6.6	3.0	11.1	11.7	12.4	13.1	13.9
Village Court Function Grant					2.2	2.2	2.4	2.5	2.6	2.8
Equalisation Grant							36.8	56.0	73.0	94.3
AUTONOMOUS BOUGAINVILLE GOVERNMENT	31.3	35.0	45.3	46.5	50.9	54.0	56.9	63.0	66.6	70.4
Police Grant				2.0	2.1	2.2	2.4	2.5	2.6	2.8
Recurrent Grant	26.3	30.0	40.3	44.5	48.6	51.5	54.5	60.5	64.0	67.7
Conditional Grant					0.2	0.3				
TRANSFERS TO STAT. INS.	178.4	207.9	206.7	234.3	221.6	226.8	229.6	234.8	240.2	245.6
INTEREST PAYMENTS AND FEES	739.6	377.0	332.8	307.0	372.9	373.5	377.6	380.9	390.7	404.1
Domestic	578.8	239.0	216.1	187.1	252.9	275.3	282.9	294.8	313.5	329.7
External	160.8	138.0	116.7	119.9	119.9	98.2	94.8	86.1	77.3	74.4
NET LENDING TO CSAs	-9.6	-10.4	-2.7	-4.2	-4.0	-4.0	-4.0	-4.0	-4.0	-4.0
TOTAL RECURRENT	2695.5	2820.4	3047.6	3014.7	3370.2	3636.3	3839.2	4095.8	4372.6	4653.8
% of GDP	21.4%	22.3%	20.0%	17.7%	18.2%	18.4%	18.6%	18.9%	19.2%	19.8%
DEVELOPMENT BUDGET										
GoPNG FUNDED PROJECTS	386.0	477.6	588.1	639.5	705.1	763.4	729.9	727.7	730.2	732.8
DOMESTIC FUNDS	207.3	331.6	431.8	471.2	509.1	526.7	524.5	532.4	540.3	548.4
INFRASTRUCTURE TAX CREDITS	40.0	34.7	20.3	23.3	33.0	73.7	42.4	32.3	26.9	21.4
CONCESSIONAL LOANS	82.8	94.6	134.0	145.0	163.0	163.0	163.0	163.0	163.0	163.0
COMMERCIAL LOANS	55.9	16.8	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
DONOR FUNDED PROJECTS										
PROJECT GRANTS	693.0	849.7	1283.1	914.6	1013.4	1123.7	1240.8	1308.7	1382.0	1461.2
TOTAL DEVELOPMENT (PIP)	1079.0	1327.4	1871.2	1554.1	1718.4	1887.1	1970.7	2036.3	2112.2	2194.0
% of GDP	8.6%	10.5%	12.3%	9.1%	9.3%	9.6%	9.6%	9.4%	9.3%	9.3%
ADDITIONAL INVESTMENT/PRIORITY EXPENDITURE			400.0	1207.0	1790.0	1476.0	410.1	182.5	49.5	0.0
% of GDP			2.6%	7.1%	9.6%	7.5%	2.0%	0.8%	0.2%	0.0%
TOTAL EXPENDITURE AND NET LENDING	3774.4	4147.8	5319.1	5775.8	6878.6	6999.4	6220.0	6314.6	6534.3	6847.8
% of GDP	30.0%	32.8%	34.8%	33.9%	37.1%	35.5%	30.2%	29.1%	28.8%	29.1%
AMORTISATION	729.4	1613.2	1673.4	1625.5	1941.0	1996.3	1734.0	1207.1	1797.1	1306.8
Domestic	283.7	1176.4	1374.0	1255.0	1423.0	1553.0	1210.5	824.9	1509.1	1180.8
External	445.6	436.8	299.4	370.5	518.0	443.3	523.5	382.2	288.0	126.0
LOAN REPAYMENTS	9.6	10.4	2.7	4.2	4.0	4.0	4.0	4.0	4.0	4.0
TOTAL PAYMENTS	4513.4	5771.4	6995.2	7405.5	8823.6	8999.7	7957.9	7525.7	8335.4	8158.6
% of GDP	35.9%	45.6%	45.8%	43.4%	47.6%	45.6%	38.7%	34.7%	36.7%	34.6%

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.

TABLE 10: CENTRAL GOVERNMENT FINANCING
(Kina Million)

	2003 Actual	2004 Actual	2005 Actual	2006 Actual	2007 Est	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj
TOTAL REVENUE AND GRANTS	3650.1	4349.6	5326.8	6311.6	7199.6	7201.7	6493.4	6436.4	6567.3	6721.4
TOTAL EXPENDITURE AND NET LENDING	3774.4	4147.8	5319.1	5775.8	6878.6	6999.4	6220.0	6314.6	6534.3	6847.8
DEFICIT (-) / SURPLUS (+)	-124.3	201.8	7.6	535.8	321.0	202.3	273.5	121.8	33.0	-126.4
% of GDP	-1.0%	1.6%	0.1%	3.1%	1.7%	1.0%	1.3%	0.6%	0.1%	-0.5%
NET EXTERNAL FINANCING	-307.0	-325.4	-163.4	-219.0	-355.0	-279.3	-360.5	-219.2	-125.0	37.0
CONCESSIONAL FINANCING	-136.5	-147.2	-84.0	-145.0	-287.0	-210.3	-288.6	-145.1	-51.0	108.0
New Borrowing	82.8	94.6	134.0	145.0	163.0	163.0	163.0	163.0	163.0	163.0
Less Amortisation	-219.3	-241.8	-218.0	-290.0	-450.0	-373.3	-451.6	-308.1	-214.0	-55.0
COMMERCIAL FINANCING	11.3	-9.9	-18.0	-11.0	-15.0	-15.0	-16.0	-16.0	-17.0	-17.0
New Borrowing	55.9	16.8	2.0	6.0	0.0	1.0	0.0	0.0	0.0	0.0
Less Amortisation	-44.6	-26.7	-20.0	-17.0	-15.0	-16.0	-16.0	-16.0	-17.0	-17.0
EXTERNAL EXTRAORDINARY FINANCING	-181.8	-168.3	-61.4	-63.0	-53.0	-54.0	-55.9	-58.1	-57.0	-54.0
New Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less Amortisation	-181.8	-168.3	-61.4	-63.0	-53.0	-54.0	-55.9	-58.1	-57.0	-54.0
NET DOMESTIC FINANCING	431.3	123.5	155.8	-316.8	34.0	77.0	87.0	97.5	92.0	89.4
DOMESTIC MARKET BORROWING	361.5	154.1	225.0	-304.0	34.0	77.0	87.0	97.5	92.0	89.4
New Borrowing	645.2	1377.9	1599.0	1130.0	1457.0	1630.0	1297.5	922.4	1601.1	1270.2
Less Amortisation	-283.7	-1223.8	-1374.0	-1434.0	-1423.0	-1553.0	-1210.5	-824.9	-1509.1	-1180.8
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	40.0	25.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER DOMESTIC FINANCING	29.8	-55.6	-69.2	-12.8	0.0	0.0	0.0	0.0	0.0	0.0
Change in check float	44.0	87.8	-102.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
End period stock	165.0	252.8	150.0	150.0	300.6	300.6	300.6	300.6	300.6	300.6
less: Beginning period stock	-121.0	-165.0	-252.8	-150.0	-300.6	-300.6	-300.6	-300.6	-300.6	-300.6
POSF financing (a)	0.0	-63.0	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	-14.2	-80.4	33.6	-12.8	0.0	0.0	0.0	0.0	0.0	0.0
NET FINANCING	124.3	-201.9	-7.6	-535.8	-321.0	-202.3	-273.5	-121.8	-33.0	126.4
<i>MEMO:</i>										
FINANCING REQUIREMENT	431.3	123.6	155.8	-316.8	34.0	77.0	87.0	97.5	92.0	89.4
% of GDP	3.5	1.0	1.0	-1.9	0.2	0.4	0.4	0.4	0.4	0.4
NET DOMESTIC FINANCING BEFORE ASSET SALES	391.3	98.5	155.8	-316.8	34.0	77.0	87.0	97.5	92.0	89.4
GROSS BORROWING	813.7	1433.7	1665.8	1268.2	1620.0	1794.0	1460.5	1085.4	1764.1	1433.2
Domestic	675.0	1322.3	1529.8	1117.2	1457.0	1630.0	1297.5	922.4	1601.1	1270.2
External	138.7	111.4	136.0	151.0	163.0	164.0	163.0	163.0	163.0	163.0
Concessional	82.8	94.6	134.0	145.0	163.0	163.0	163.0	163.0	163.0	163.0
Commercial	55.9	16.8	2.0	6.0	0.0	1.0	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
Financing gap										
GROSS AMORTIZATION	729.4	1660.6	1673.4	1804.0	1941.0	1996.3	1734.0	1207.1	1797.1	1306.8
Domestic	283.7	1223.8	1374.0	1434.0	1423.0	1553.0	1210.5	824.9	1509.1	1180.8
External	445.6	436.8	299.4	370.0	518.0	443.3	523.5	382.2	288.0	126.0
Concessional	219.3	241.8	218.0	290.0	450.0	373.3	451.6	308.1	214.0	55.0
Commercial	44.6	26.7	20.0	17.0	15.0	16.0	16.0	16.0	17.0	17.0
Extraordinary	181.8	168.3	61.4	63.0	53.0	54.0	55.9	58.1	57.0	54.0

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)

	2003	2004	2005	2006	2007
	Actual	Actual	Actual	Actual	June*
Domestic Credit	1792.8	1798.9	2241.1	3036.4	3638.4
% Change	-6.2%	0.3%	24.6%	35.5%	34.9%
Net Credit to Central Government	1253.0	1293.5	1114.1	962.4	843.3
% Change	-8.3%	3.2%	-13.9%	-13.6%	-35.2%
Credit to Private Sector	1707.4	1723.6	2132.8	2948.9	3556
% Change	-4.1%	0.9%	23.7%	38.3%	35.5%
Money Supply	3410.5	3914.8	5069.3	7040.2	7793.1
% Change	-4.4%	14.8%	29.5%	38.9%	35.5%
Money Velocity (M3*) (average)	3.7	3.2	3.0	2.4	2.4

Source: BPNG

*through -the -year change

TABLE 12: PUBLIC DEBT
(Kina Million, unless otherwise stated)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Actual	Actual	Actual	Actual	Est	Proj	Proj	Proj	Proj	Proj
Domestic	3,022.9	3,181.2	3,403.8	3,101.0	3,135.1	3,211.8	3,298.9	3,396.3	3,488.3	3,577.7
Treasury Bills***	2,755.3	2,236.2	1,796.5	1,194.0	934.2	815.5	705.8	656.6	598.5	538.0
Inscribed Stock	174.7	898.0	1,567.9	1,883.0	2,182.8	2,382.8	2,582.8	2,732.8	2,882.8	3,032.8
Other Domestic debt**	92.9	47.0	39.4	24.0	18.2	13.6	10.3	7.0	7.0	7.0
<i>Domestic debt as % GDP</i>	24.1%	25.1%	22.3%	18.2%	16.9%	16.3%	16.0%	15.7%	15.3%	15.2%
External	4,901.1	4,409.5	3,856.0	3,631.1	3,337.3	3,058.2	2,698.0	2,478.9	2,354.3	2,392.4
International Agencies	4,717.4	4,239.5	3,723.0	3,507.2	3,234.0	2,969.6	2,625.4	2,422.8	2,315.0	2,370.4
Commercial Loans	183.7	170.0	133.0	123.9	103.3	88.6	72.6	56.1	39.3	22.0
Other Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>External debt as % GDP</i>	39.0%	34.9%	25.3%	21.3%	18.0%	15.5%	13.1%	11.4%	10.4%	10.2%
Total Public Debt Outstanding	7,924.0	7,590.7	7,259.8	6,732.1	6,472.5	6,270.1	5,996.9	5,875.3	5,842.6	5,970.2
<i>As % GDP</i>	63.1%	60.0%	47.6%	39.5%	34.9%	31.8%	29.1%	27.1%	25.7%	25.4%

Source: BPNG and Department of Treasury.

**Includes Temporary Advance Facility

TABLE 13: OTHER MAJOR ASSUMPTIONS UNDERLYING THE BUDGET

	2003 Actual	2004 Actual	2005 Actual	2006 Actual	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj
Inflation										
Average on Average (%)	14.7	2.1	1.7	2.3	1.8	5.2	3.4	3.1	3.1	3.1
Dec on Dec (%)	8.5	2.4	4.5	-0.3	4.2	3.2	3.2	3.1	3.1	3.1
Exchange rate										
Real Exchange Rate Index (2007 = 100)	79.3	95.6	97.2	97.8	100.0	104.2	105.1	105.7	106.3	106.9
Interest rate										
T/Bills (average for the year)	18.3	9.0	4.5	5.0	5.0	6.0	6.0	6.0	6.0	6.0
Inscribed Stock (3 year yield)				6.0	5.7	6.0	6.0	6.0	6.0	6.0
Mineral Prices										
Gold (US\$/oz)	363	409	445	604	662	662	662	662	662	662
Copper (US\$/lb)	0.81	1.30	1.67	3.05	3.28	2.45	1.84	1.43	1.22	1.18
Oil (Kutubu Crude: US\$/barrel)	27.4	42.1	53.4	64.3	67.3	61.9	61.7	60.1	59.4	59.0

Source: Department of Treasury.