2009 NATIONAL BUDGET

VOLUME 1
ECONOMIC AND DEVELOPMENT POLICIES

For the year ending 31st December, 2009

PRESENTED BY

HON. PATRICK PRUAITCH, MP
MINISTER FOR TREASURY AND FINANCE

ON THE OCCASION OF THE PRESENTATION OF THE 2009 NATIONAL BUDGET

HON. PATRICK PRUAITCH, MP
MINISTER FOR TREASURY AND FINANCE

FOREWORD

The 2009 Budget is being delivered amid very uncertain economic circumstances. The world has experienced the most severe financial crisis since the 1930's Great Depression. Across the world, major financial institutions have failed and stock markets have fallen dramatically. The global financial crisis is affecting economic growth prospects in both advanced and developing countries.

The extent of this crisis and the effects of the global downturn cannot be underestimated. Papua New Guinea is not immune from the fallout, with the commodity prices we receive for our exports and the fiscal outlook having deteriorated rapidly in recent months.

Given these developments, the Government is using the 2009 Budget to *promote sustained economic growth and to further empower and transform the rural economy.*

Despite the challenges ahead, the Papua New Guinea economy is forecast to grow at 6.2 per cent in 2009, the country's seventh consecutive year of economic growth. In-line with the International Monetary Fund's 2009 growth outlook for emerging and developing countries, this forecast is a little lower than the 7.2 per cent revised growth forecast for 2008 and reflects the continued fallout from the global financial crisis on the Papua New Guinea economy.

The deteriorating outlook for world growth has contributed to substantial falls in commodity prices over recent months, including for our major exports. Oil prices have fallen dramatically in recent months from a peak of over US$140 barrel in July 2008. Copper and gold prices have also fallen sharply, as have agricultural commodity prices.

After benefiting from several years of low inflation, the past year has seen inflation in the country rise to uncomfortably high levels, driven by rapid growth in money supply and credit, strong domestic demand, increased Government expenditure and rising prices of oil and food. While inflation has been high in 2008, inflation is forecast to fall to a more manageable 6.1 per cent in 2009 given the weakness in the global economy that has seen oil prices, and some international food prices, such as rice and wheat, fall, and the lagged effects of the recent appreciation of the Kina against major trading currencies.

The Government's recently released *Medium-Term Fiscal Strategy (MTFS) 2008-12* provides a stable, responsible and prudent framework for the Government to ensure fiscal sustainability and promote macroeconomic stability over the medium term. Importantly, the MTFS anticipated the possibility that unusually high commodity prices experienced in recent years could fall sharply and result in a rapid fall in revenue. To this end, the MTFS ensured that the windfall revenue was not added to ongoing spending and was used to reduce the Government's public debt and superannuation liabilities or fund one-off additional priority expenditures.

With respect to planned expenditure in 2009, the Government has sought to align planned expenditures with forecast revenues while continuing to pursue its ambitious development priorities for the nation. The Government has also sought to insulate the economy from the current uncertainties and threats present in the global economy.

Overall, the Government's clear priority is to promote sustainable economic growth through empowering and transforming the rural economy. As a result, the Government has used the 2009 Budget to:

- Significantly expand the District Services Improvement Program in 2009, with planned funding being in addition to the substantial funding per district previously allocated in 2007 and 2008.
- Undertake substantial investments in agriculture, infrastructure maintenance, improvement and development, in accordance with the Government's strategic plans and other priorities.

The Government is mindful that in a rapidly changing economic environment, major uncertainties exist with the 2009 Budget. While the Government has been realistic with its economic assumptions and revenue forecasts, the Government recognizes that Government expenditure will need to be closely monitored in 2009, and, if needed, adjusted as economic circumstances dictate.

Nevertheless, the Government has substantial amounts in trust funds that were saved during the commodity boom period. These funds will be spent on infrastructure development over the next few years and should help to shield the PNG economy from some of the worst impacts of the international downturn. In addition, the LNG project has now entered the FEED stage and a decision will be made towards the end of 2009 about proceeding with the project. If this project proceeds, it will provide a substantial boost to economic growth and jobs in the PNG economy over the medium term.

The Government also realizes that the economy would be strengthened through further economic reforms to the private and public sectors. Government priorities for 2009 include pursuing opportunities for structural reform that encourage investment and promote a competitive private sector; as well as implementing existing public sector reform programs and ensuring that their progress does not stall.

The economic circumstances we face are challenging and the Government acknowledges that there may be difficult times ahead. However, the Government remains optimistic that through the adoption of prudent policies that promote macroeconomic stability and fiscal sustainability, the economic future of this country can be secured and our development priorities met.

I commend the 2009 Budget to Honourable Members and to the people of Papua New Guinea.

HON. PATRICK PRUAITCH, MP
Minister for Treasury and Finance

CONTENTS

FIGURES

TABLES

CHAPTER 1. ECONOMIC AND FISCAL DEVELOPMENTS

1.1 OVERVIEW

The PNG economy has continued to grow at strong rates over recent years, benefiting from half a decade of extremely favorable global economic conditions, with strong and sustained world growth, benign inflation and surging commodity prices. However, the global financial crisis has led to a severe deterioration in the global economy, with a recession expected in the advanced economies, and a significant slowdown in developing countries. This has translated into sharply lower commodity prices, which will have a major impact on the PNG's economic and fiscal outlook going forward.

The PNG economy is expected to record its strongest sustained rates of growth over 2007 and 2008. Real GDP growth in 2007 was 6.5 per cent, and is expected to increase to 7.2 per cent in 2008. This growth has been underpinned by record high commodity prices, macroeconomic stability, prudent fiscal and monetary policies, increased business confidence, high rates of private sector borrowing, microeconomic reforms and political stability.

Growth has been broad based, driven primarily by the non-mining sectors, in particular the communication, construction and retail sectors. Non-mining GDP growth is estimated at 7.3 per cent in 2007, and expected to be 7.9 per cent in 2008, the highest sustained rates ever recorded.

This has resulted in an unprecedented surge in formal sector employment, which has grown at near double digit rates since 2006. This has been broad based, with above trend increases in most sectors, in particular the building and construction and retail and wholesale sectors, which have grown at consistently strong rates over the past 3 years.

Table 1: Principal Economic Indicators

	2005 Actual	2006 Actual	2007 Actual	2008 Proj
Real GDP Growth (%)*	3.6	2.6	6.5	7.2
Real Non-Mining GDP Growth (%)	3.4	3.8	7.3	7.9
Employment Growth (%)	1.1	8.2	9.4	7.6*
Inflation (year average((%)	1.8	2.4	0.9	10.6
Treasury Bill Rate (%)	4.5	5.0	5.0	6.5
3 year Incribed Stock yield (%)		6.0	5.7	6.0
Gold (US$/oz)	444.9	604.3	697.0	863.0
Copper (US$/lb)	1.7	3.1	3.23	3.21
Oil (US$/barrel)	53.4	64.3	72.3	102.0

Sources: National Statistical Office, International Monetary Fund, Department of Treasury, Bank of Papua New Guinea.
* GDP data for 2005, 2006, 2007 and 2008 are Department of Treasury's estimates. Employment growth is the change in formal non-mining employment through-the-year.
* Employment growth for 2008 is at June qtr 2008. (QEB)

As a result of surging commodity prices, which have been at record levels over recent years, Government revenues increased substantially, allowing the Government to increase expenditures. By using most of the windfall revenues prudently, paying off public debt, repaying outstanding commitments, and placing the funds in trust to be spent gradually over the medium term, rather than in an inflation inducing burst that could lead to macroeconomic

instability, the Government has maintained a relatively prudent fiscal stance. This has been guided by the adoption of the Medium Term Fiscal Strategy, and the continued use of the Medium Term Development and Debt Management Strategies.

Inflationary pressures have increased significantly, with year average inflation of 10.6 per cent expected in 2008. This increase has been due to strong money supply and credit growth, the positive terms of trade shock, rapid private sector expansion into an economy facing capacity constraints and increased government expenditure. This has been exacerbated by rising global food and energy prices, which have increased the cost of a number of consumer staples, such as rice, fuel and flour.

Monetary policy has reacted to increased inflation but monetary conditions remain too loose for the circumstances. Official interest rates have increased by 100 basis points in 2008, although this has had no noticeable impact on money or credit growth. The exchange rate has appreciated significantly in 2008, particularly against the Australian dollar, reflecting the sharp depreciation of the A$ against most other currencies, and more steadily against he US$. The appreciation will help ease inflationary pressures, although it will also reduce the competitiveness of domestic producers.

In the second half of 2008, global conditions took a sharp turn for the worse, unfolding into a full blown global financial crisis in September 2008, with the failure of a number of major international financial institutions. These events have caused a severe deterioration in the global economic outlook (see Box 1).

The freezing of global credit markets, loss of confidence in the international financial system, massive declines in asset prices, and sharp falls in business and consumer confidence around the world are resulting in a major recession in the developed economies, including the US, Europe and Japan, and a marked slowdown in developing economies such as China, India and South East Asia.

The global slowdown has resulted in sharp declines in the prices of PNG's export commodities, with oil and copper falling by more than 50 per cent from the record high prices recorded in July 2008. This has had a major impact on the export values of PNG's commodities, and has resulted in a substantial fall in mineral revenue collections by the Government. It will also have major implication to the balance of payments, with the current account expected to swing from a large surplus in 2008 to a deficit position in 2009.

The global downturn has radically changed the conditions in which the PNG economy operates, with the boom conditions of the previous three years appearing to be at an end.

This will require a significant adjustment in expectations regarding new Government expenditure, which will have to adjust to match the substantial decline in revenues. By following the Medium Term Fiscal Strategy during the boom years, ongoing spending was kept in line with normal revenue, which could be expected in the absence of a commodity boom. Now that the boom appears to be over, there are unlikely to be additional funds allocated. Nevertheless, the funds that are currently in trusts accounts will bolster actual Government spending over the next few years, smoothing the impact of the commodity price boom.

Box 1: GLOBAL FINANCIAL CRISIS

The turmoil and weakness experienced by world financial markets has been some of the most significant since the 1930's Great Depression. This instability and uncertainty is now posing a major threat to global growth.

These developments began with the emergence of the sub-prime mortgage crisis in the United States in mid-2007, which caused losses around the globe on these instruments and financial institutions to lose confidence in lending to each other.

The US sub-prime crisis was caused by two major factors:

- A downturn in US housing markets, where prices have fallen by more than 20 per cent since mid-2006. This resulted in increased defaults, and the failure of many mortgages to be paid. These mortgages are now bad loans, and have to be written down by the lenders. Unfortunately, these loans make up a major portion of many of the assets of the world's banks, finance companies, governments and insurance companies.

- Large numbers of mortgages have been bundled up and sold off as complex financial instruments called Mortgage Backed Securities. Many of these were given AAA credit ratings, and were purchased by companies on the assumption that they were safe assets. With the increased rate of default on mortgages, these assets have lost value. However, because they are so complex and opaque, the true value of these assets is unknown, so no-one is willing to buy them, making them worthless in the current market.

Significantly higher borrowing costs, risk premiums and higher interest rates are a major risk for households, firms and Governments who hold high levels of debt, particularly if that debt is short term, which needs to be rolled over quickly.

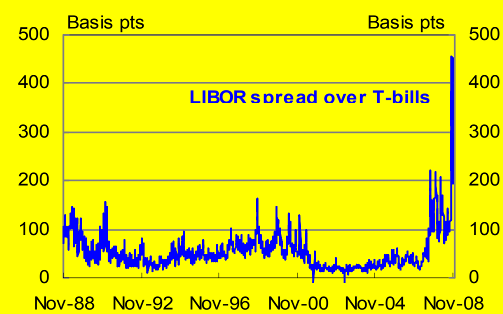
The situation dramatically worsened in mid-September 2008 with a number of the world's largest banks and financial institutions, including Lehman Brothers, Bear Stearns, American International Group, Fannie Mae and Freddie Mac either failing or teetering on the edge of bankruptcy.

The financial crisis has not been restricted to the United States, with financial institutions also collapsing in the United Kingdom, Germany, France, Ireland, Belgium, the Netherlands and Iceland.

The collapse of these financial institutions, created great uncertainty and fear across financial markets. Confidence plunged and banks were unwilling to lend to each other or other businesses, out of fear that the borrowers will fail and be unable to repay the debts. This caused a credit crunch, resulting in a significant increase in risk premiums, increasing the cost of borrowing significantly.

The immediate effect of the credit crunch is illustrated in the chart below, where the spread between the rate at which banks lend to each other and the risk free 3 month US Treasury Bill rate reached nearly 400 basis points in October 2008.

Credit spreads – US LIBOR vs 3 month T-Bills



The major impact to date on PNG arising from the global financial crisis has been a sharp fall in commodity prices of PNG's exports and a large fall in Government revenue. In addition, equity markets have

also fallen broadly in line with international developments. On a more positive note, the international factors that were driving inflation in PNG in early 2008 have now reversed. Banks in PNG have also been relatively unaffected to date by the global fallout, largely because of their heavy reliance on domestic deposits as a source of funds.

In response to this crisis, several countries have implemented emergency measures to support financial institutions. The United States Congress has recently approved the US$700 billion *Emergency Economic Stabilization Act of 2008* in the hope that this will help restore financial institutions' balance sheets, and also create a functioning market for the securities.

In the past, it would have been expected that a financial crisis of this magnitude would have already affected the PNG economy significantly.

One factor that has helped the economy to date has been the halving of public debt over the past five years (when measured as a percentage of GDP), as well as the rebalancing of the debt portfolio towards domestic and longer maturity debt – which has resulted in improvements to PNG's credit rating.

Going forward, the International Monetary Fund in its 2009 World Economic Outlook has indicated that the world economy is decelerating quickly and *"is entering a major downturn in the face of the most dangerous financial shock in mature financial markets since the 1930s".*

In light of this bleak outlook, it has become clear that the flow-through of the financial crisis to the global economy is going to be much more severe than first anticipated.

The large commodity price falls have been accompanied by a significant increase in volatility, making it exceptionally difficult to forecast commodity prices in 2009, and increasing the uncertainty and downside risks surrounding the revenue projections for 2009. The 2009 Budget commodity price assumptions will need to be monitored carefully going forward. Similarly, the sharp appreciation of the exchange rate (on a trade weighted index basis) over recent months is likely to result in a loss of competitiveness. This is at a time when the current account position is likely to swing from a large surplus to a large deficit position. These developments will also need close monitoring.

Despite the global downturn, domestic growth prospects for the PNG economy remain relatively favorable, with above trend economic growth expected to continue in 2009, albeit at a more moderate pace. The banking sector, which is reasonably well capitalized, and sources most of it's funding through domestic deposits, is expected to remain relatively protected from the financial turbulence elsewhere in the world, allowing for continued private sector expansion.

At the same time, public sector capital expenditure is anticipated to continue to increase, primarily through increased utilization of funds that have been placed in trust over previous years. This illustrates the benefits of spreading the use of the windfall revenues from the commodity price boom over the medium term, rather than spending them as they are received, which would have required deep expenditure cuts as commodity prices and mineral revenues fell. Nonetheless, the rate at which these funds are drawn will need to be carefully monitored and controlled, in order to prevent adding to inflationary pressures in a high inflation environment.

The risks to both the economic and fiscal outlook are very much on the downside. Further falls in commodity prices below the Budget assumptions would have a major impact on mineral exports and the Government's budget position.

The falls in commodity prices have not been limited to minerals, and include agricultural prices. For example, the prices of palm oil and copra oil have fallen by around 50 per cent and 40 per cent respectively since July 2008. Combined with the appreciation of the Kina, this could potentially affect production, as marginal producers reduce output in response to lower prices.

While it appears that the availability of funding for private sector expansion will not be a major impediment to growth, if confidence effects from the global financial crisis take hold in PNG, there could be a slowing of the very strong private sector expansion experienced over recent years.

In addition, the PNG economy is heavily reliant on a small number of producers, meaning that unexpected shutdowns – due to events such as landowner problems, weather or technical issues – can have a major impact on the economy and revenue flows.

One factor that will assist to reduce the risks to public finances during these turbulent times is the reduction in public debt that has occurred over the past 5 years. Total Public debt has been reduced from 72 per cent of GDP in 2002 to 33.8 per cent of GDP as at the end 2007. By end 2008, public debt is expected to decline further to 28.8 per cent of GDP. This has freed up resources within the Budget, and has helped shield public finances from some of the upheavals in global financial markets. It will also provide some room to maneuver in the event of a shortfall in revenue if commodity prices continue to fall.

1.2 GROSS DOMESTIC PRODUCT

2007 Updates

The PNG economy grew by an estimated 6.5 per cent in 2007, up substantially from the estimated growth of 2.6 per cent in 2006 and was the sixth successive year of economic growth. The economy continued to grow very strongly in 2007 due to stable macroeconomic policies, improved business confidence, microeconomic reforms and high commodity prices.

Total estimated non-mining GDP grew by 7.3 per cent in 2007, up substantially from 3.8 per cent in 2006. This reflected exceptionally strong growth in the communication and construction sectors as well as robust growth in the wholesale and retail, manufacturing and agriculture, forestry and fisheries sectors.

The communication and transport sector grew exceptionally strongly by around 40 per cent in 2007 in response to microeconomic reforms that allowed competition in the mobile phone industry. Both the existing operator and the new entrant expanded operations. This increased subscriber numbers substantially and saw a major contribution from this sector to overall economic activity.

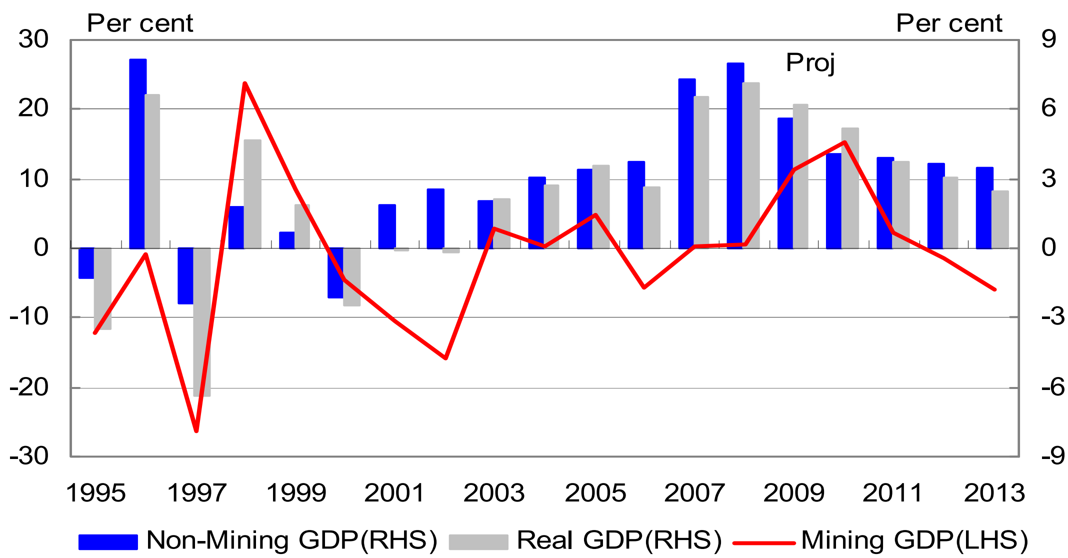
The construction sector grew very strongly by 16 per cent in 2007, reflecting the construction of the Ramu Nickel project, the new mines of Simberi, Sinivit and Hidden Valley, increased private sector building activity and increased government expenditure on infrastructure maintenance. The wholesale and retail sector grew by a strong 10 per cent in 2007 and the manufacturing sector grew by 6 per cent.

The agriculture, forestry and fishing sector also experienced robust growth of around 4 per cent in real terms in 2007. In agriculture, increased production of coffee, palm oil, copra oil and tea were the major drivers of growth.

The mining and quarrying sector is estimated to have increased slightly by 2 per cent in real terms in 2007, reflecting normal production from the existing mines supported by the commencement of the Sinivit gold mine. The Lihir and Porgera mines have ramped up gold production through their expansion plans, more than offsetting lower gold and copper production from the Ok Tedi mine.

The oil and gas extraction sector declined by 5 per cent in real terms in 2007, due to production declines for Kutubu and Gobe, partially offset by increased production from the Moran and SE Manada fields. This shows the extent of the natural decline from the existing fields, even though the world prices of crude oil continued to be very high.

Figure 1: Economic Growth: 1995 – 2013



Source: 2008 Updates - Department of Treasury

2008 Outlook

In 2008, real economic growth is expected to be 7.2 per cent – the highest growth since 1993. This is broadly in line with forecast GDP growth of 7.3 per cent expected in the 2008 Mid Year Economic and Fiscal Outlook (MYEFO), although, the composition of growth has altered, with a large downward revision to expected oil production, partially offset by a broad upward revision across many of the non-mineral sectors.

The strong Gross Domestic Product (GDP) growth in 2008 is broad based and mainly driven by the non-mining sectors. The mining and quarrying sector is also expected to expand, largely due to increased production from Porgera and Ok Tedi. Oil production is expected to decline in 2008, as existing fields continue to mature, resulting in lower extraction rates.
Total non-mining GDP is expected to expand by 7.9 per cent in 2008, the strongest growth in over a decade, driven by continued robust growth in transport, storage and communication, construction, wholesale and retail trade, finance, real estate and business and the agriculture, forestry and fisheries sectors.

The transport storage and communication sector is expected to expand by a further 40 per cent in 2008, driven by the communication sector through the continued expansion of mobile phone services. The interconnectivity of the two networks in the year has further expanded

operations and increased the number of subscribers substantially, and has vastly contributed to increased domestic activity in the economy. Subscribers to mobile networks are now estimated to be around one million, and activity related to the sector is now estimated to have contributed around 2 per cent to GDP.

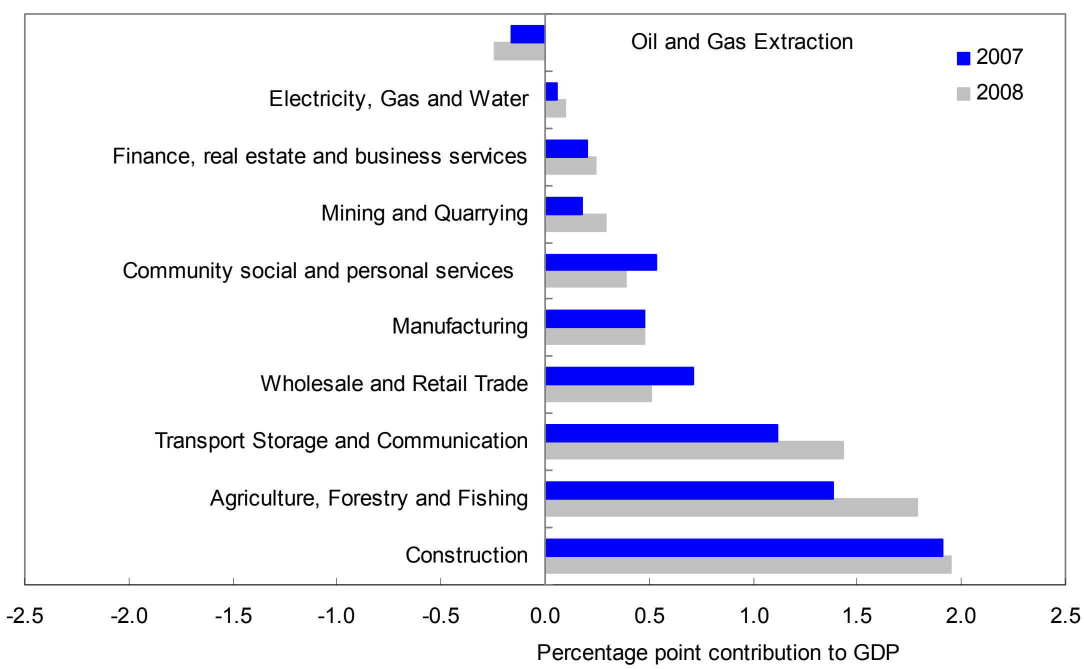
The construction sector is expected to grow strongly by 15 per cent in 2008, with continued demand from both the private and public sectors. However, growth is expected to return to more moderate levels in the future. This is due to the construction sector operating at full capacity, which means that further growth requires increased capacity, rather than increased utilization of spare resources as observed over recent years.

Growth in the agriculture, forestry and fishing sector is expected to accelerate in 2008 to around 5 per cent. The robust growth in agriculture reflects increased production of copra, copra oil, coffee, cocoa and palm oil. This was supported by higher prices in the first half of 2008.

However, in the second half of 2008, prices of most agriculture commodities fell dramatically, in line with the drop in demand for commodities due to the global economic downturn. Since June 2008, agricultural commodity prices have fallen as follows: oil palm by 52 per cent; copra oil 40 per cent; cocoa 22 per cent; and coffee 11 per cent.

Other non-mineral sectors, such as wholesale and retail, finance, real estate and business, manufacturing, and community, social and personal services sectors are expected to have grown strongly in 2008, supported by low interest rates and increased business confidence in line with macroeconomic stability. Growth in these sectors is strongly supported by high employment and lending growth.

Figure 2: Contribution to Growth by Industry in 2007 and 2008.



Source: 2008 Update - Department of Treasury

The mining and quarrying sector is expected to grow by 4 per cent in 2008, reflecting slightly higher production from the existing mines and the commencement and initial ramp up of the

Simberi and Sinivit gold mines. Porgera and Ok Tedi are expected to increase production in 2008, while production from Lihir and a number of other small mines is anticipated to decline in 2008.

The oil and gas extraction sector is expected to decline by 8 per cent in 2008, reflecting a fall in annual total oil production of around 1.3 million barrels. This represents a continuation of the natural decline from all existing fields, despite increased workover due to high oil prices.

Commodity prices have fallen dramatically in the second half of 2008, after increasing to record levels during the first half of the year. Since July 2008, the prices of oil and copper have fallen by more than 50 per cent, and the price of gold has declined by around 30 per cent (see Box 2). This has reduced the value of PNG's exports significantly, and introduced great uncertainty as to where prices will settle. However, as most of PNG's mineral operations appear to be, in general, low marginal cost producers, the prices falls to date are not expected to reduce production volumes.

Box 2: Commodity Price Collapse

Commodity prices have collapsed after being abnormally high for the last five years. Prices peaked in July 2008 and have since plunged.

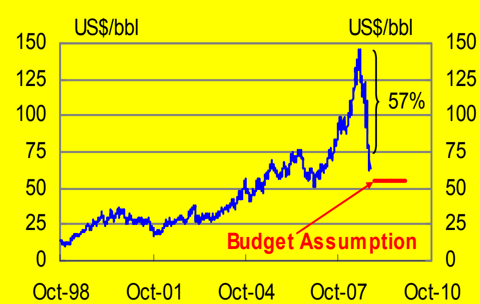
Two opposing trends were evident in 2008. Commodity price began to skyrocket towards the end of 2007 and in the first six months of 2008 reached uncharted territory. This massive run up in prices came during a time when world demand was growing beyond the capacity of supply to respond, and risk premiums were building due to intensifying geopolitical concerns.

By July 2008, oil surged past US$145 per barrel, copper reached US$8900 per tonne and gold reached US$950 per ounce. Since the emergence of the global financial crisis, the situation has changed dramatically, with commodity prices falling sharply in the second half of 2008 as the outlook for world growth deteriorated.

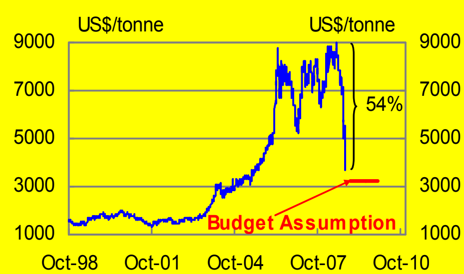
The financial crisis has resulted in into a major slowdown in growth. The IMF has revised down global growth prospects in their latest revised WEO. Global economic growth is expected to slow from 5 per cent in 2007 to 3 ¾ per cent in 2008 and to just over 2 per cent in 2009.

This slowdown in growth has triggered a fall in demand across the advanced economies, especially in the US, European Union and Japan. The US economy has been the worst

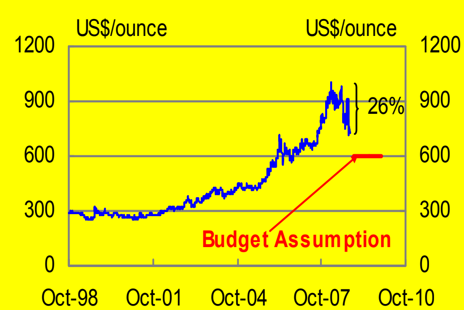
Oil Price



Copper price



Gold Price



hit by the global financial crisis. Activity has slowed down significantly and the US economy is now teetering on the verge of a recession. Since the US economy is the largest consumer of energy, its decline has reduced demand for commodities, with prices falling sharply and by large amounts.

Oil and copper prices have fallen dramatically in light of these developments.

Since July 2008 oil prices have fallen by a substantial 57 per cent, copper prices have fallen by 54 per cent and gold prices are down 26 per cent.

The prices of agricultural commodities have also fallen sharply. Since peaking earlier in the year, the price of PNG's key agricultural exports have fallen as follows: copra is down 52 per cent, palm oil is down 36 per cent, cocoa is down 33 per cent, and coffee has fallen by 15 per cent.

The impact of recent price commodity price falls has adversely affected PNG's export values and government revenues.

The recent commodity prices falls will have a significant impact on the third and final tranches of mining and petroleum taxes paid in late 2008.

The revenue projections for 2008 have also been affected by the recent appreciation of the Kina which has reduced the Kina value of Mining and Petroleum Taxes. In addition, unexpected hedging losses from owners of several major oil fields are also expected to reduce revenues, including previously expected arrears payments from 2007.

The price assumptions for 2009 are US$55 per barrel for oil, US$3250 per tonne for copper and US$600 per ounce for gold.

Given the major falls in commodity prices over recent months, these assumptions could be breached in 2009. If this occurs the Government will review the Budget.

Over the medium term, commodity prices are assumed to return to 10 year averages. The price of oil is assumed to be US$46 per barrel, the price of copper is assumed to be US$3540 per tonne and the price of gold is assumed to be US$445 per ounce.

2009 Outlook

Real GDP is forecast to increase by 6.2 per cent in 2009. This represents some moderation from the exceptionally high growth rates in 2007 and 2008 and reflects the impact of further expansion in the mobile phone sector, but at a slower pace; as well as a slow down – albeit from very high levels – of growth in construction activity, which is running up against capacity constraints, reducing the scope for further expansion in the industry.

It also reflects opposing trends in the mining and petroleum sectors, where a large fall in oil production due to the decline of existing oil fields is expected to be offset by strong growth in the mining sector, where a number of new mines are scheduled to commence (although the fall in commodity prices could dampen new expansion).

While the domestic economy is not expected to be significantly affected by the global downturn, there is a distinct risk that business and consumer confidence could weaken, which would reduce private sector activity. Combined with the effect of falls in commodity (both mineral and agricultural) and asset prices, this presents a significant downside risk to the economic outlook.

The Agriculture, Forestry and Fisheries sector is expected to grow by a solid 4 per cent in 2009. The major driver of this growth is copra and copra oil, where increased production in Bougainville, an expansion in the number of export licenses and the revitalisation of

plantations is expected to provide a significant boost. Coffee, cocoa and palm oil are also expected to grow strongly. There are some downside risks to these forecasts, due to the large declines in agricultural prices over recent months, which will reduce export revenues, and could lead to lower expansion and output, as producers respond to falling prices.

The Petroleum sector is expected to decline by 7 per cent in 2009, as production from existing fields continues to mature and decline. The Mining and Quarrying sector is expected to grow substantially by 17.5 per cent in 2009. The expected increase is due to increased production in the major mines of Ok Tedi, Porgera and Lihir, as well as the progression of newer mines, such as Hidden Valley, Simberi and Sinivit into the production and ramp up phase of operations.

In the non-mineral sector, the communication and construction sectors are again expected to be the major drivers of growth. While the expansion in the mobile phone sector is expected to slow somewhat from the exceptional rates of 2007 and 2008, the subscriber base is still expected to increase, as the two operators continue to expand operations throughout the country.

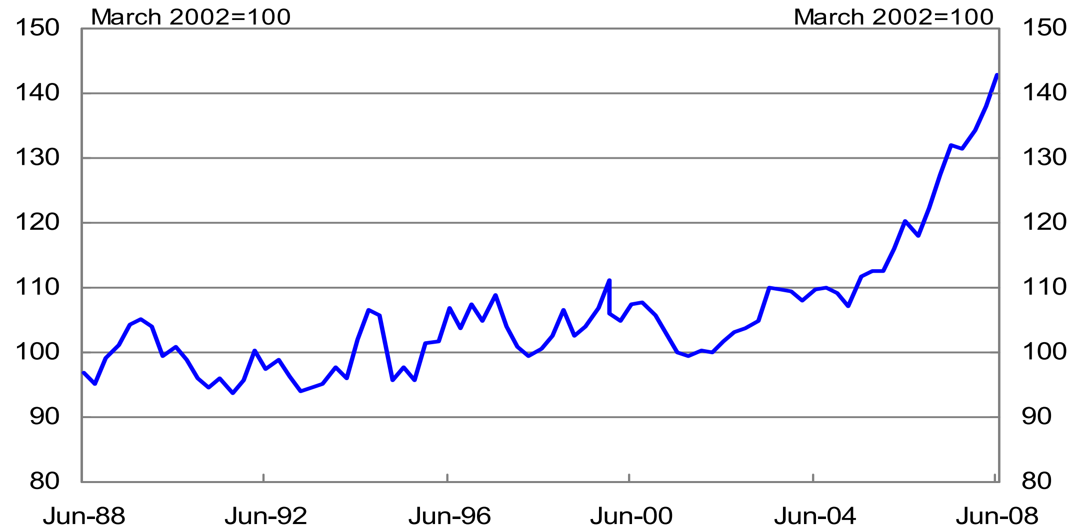
The construction sector is expected to continue to grow solidly due to increased donor funds and government spending for rehabilitation and maintenance, as well as a build up in capacity. Construction is also being supported by increased private sector investment including new projects in the construction phase like the Ramu Nickel mine, as well as some preparatory work for the LNG project (although this is anticipated to be fairly small). The combination of low interest rates and strong domestic demand is also being translated into several new residential and commercial building projects.

Underlying the strong but more moderate growth for 2009 is the assumption of continued fiscal discipline, political stability and prudent macroeconomic policies. However, there are a number of risks, including unforeseen shutdowns in the mineral sector, further volatility and/or declines in commodity prices associated with deteriorating world economic growth prospects, the spread of the financial crisis into the PNG financial system, and the impact of large exchange rate fluctuations.

1.3 LABOUR MARKET

Total non-mineral sector employment grew strongly by 10.2 per cent in 2007 with strong employment growth in retail, agriculture, forestry and fisheries, manufacturing and construction sectors. The increased economic activity in the non-mineral sector, in particular, the boom in the construction sector and increase in small holders’ production of key agriculture commodities has heightened employment growth in these sectors. One of the major capacity constraints faced by construction companies is skilled labour. Employment in the mineral sector recorded substantial growth of 15.7 per cent in 2007.

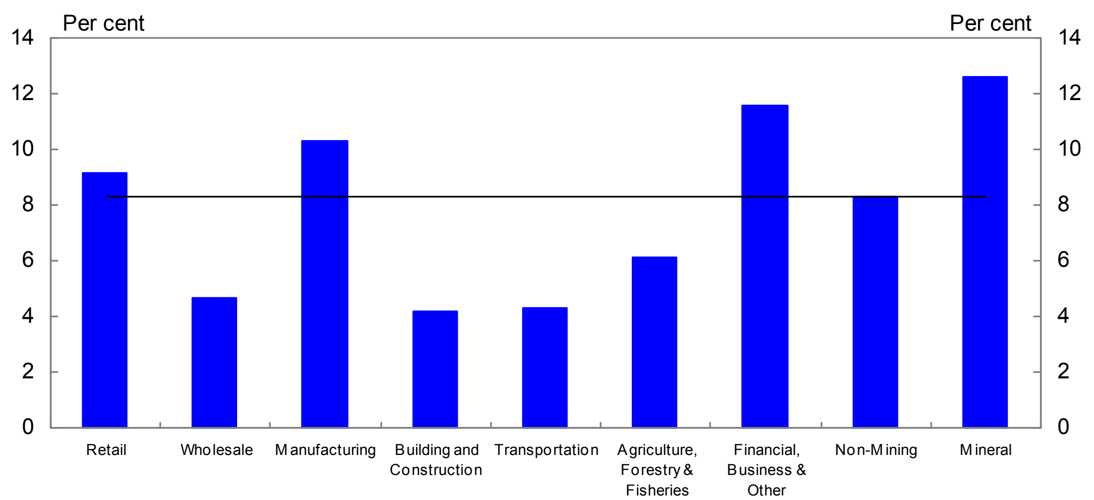
Figure 3: Employment Index



Source: 2008 Updates – BPNG

In the year to June quarter 2008, total private non-mining sector employment rose by 8.3 per cent, driven mainly by strong employment growth in finance, real estate and business services, manufacturing and retail sectors. Employment in the mineral sector was also high in the year to June quarter 2008, rising by 12.6 per cent.

Figure 4: Employment Growth by Sector – June 2008 (through the year)



Source: 2008 Updates - BPNG and Department of Treasury

The increase in employment growth is attributed to the impact of strong sustained economic growth over recent years, which followed a prolonged period of relatively stagnant employment growth in the formal sector. Stable macroeconomic conditions, improved business confidence and microeconomic reforms have had a considerable impact on employment growth in both the mineral and non-mineral sectors.

1.4 PRICES

After a number of years of low and stable inflation, inflationary pressures began to emerge in 2007, when underlying inflation picked up considerably. This flowed through to the headline measure of consumer prices, which increased by 13.5 per cent through the year to the September quarter 2008. This is a significant increase in inflation, and represents the highest rate since 2003, when the PNG economy was in considerable difficulty.

In 2008, inflation is projected to be 10.6 per cent in year average terms. This is due to price increases in almost all categories of consumer goods and services, and all regions of PNG. The major contributors to inflation over the past year have been higher food prices – due to increases in prices of imported items, such as rice, and local products such as sweet potato and market goods which do not appear to be affected by supply shocks like drought. The other major driver for most of 2008 has been increased fuel prices, which increased in line with higher world oil prices.

Over the past two years, the build up in inflationary pressures has come from a combination of external and domestic factors. On the external side, rising prices and a slight trend depreciation of the Kina have added to inflationary pressures, with tradeable inflation up 12.1 per cent over the year to September 2008. On the domestic side, excess liquidity in the system, strong economic growth, and increased pricing power combined with capacity constraints are resulting in higher prices, with non-tradeable inflation up 15.1 per cent through the year to the September quarter 2008.

More specifically, the major factors contributing to the high inflation outcome in 2008 includes:

- The fast growth in monetary aggregates – while monetary policy has reacted to rising inflation by increasing the benchmark Kina Facility rate to 7 per cent in 2008, the worrying rates at which money supply and credit to the private sector are growing indicates that there is a substantial amount of liquidity in the system which is imparting significant inflationary pressure;

- The terms of trade boom – This has substantially increased Government revenues since 2005 through the commodity price boom. While the Government has taken the opportunity to increase spending in the budget and through supplementary budgets – adding significant stimulus into the economy, great potential for further spending remains from trust accounts which needs to be carefully monitored to avoid adding fuel to the fire; and

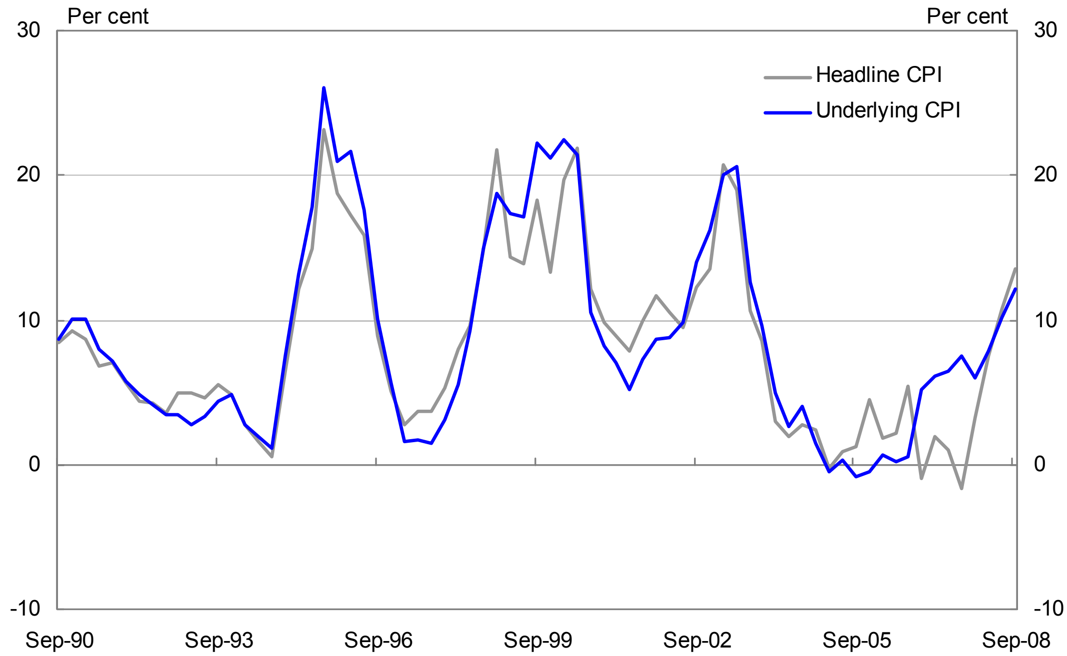
- The rapid expansion in the private sector, which continues to be assisted by increased business confidence, relatively low interest rates and higher profitability which is now running up against significant capacity constraints. This is resulting in skill shortages, higher wage demands and increasing willingness of businesses to pass on higher cost to consumers.

Looking forward, inflation is expected to slow from the worryingly high rate of 10.6 per cent forecast for 2008 to 6.1 per cent in 2009. Underlying this forecast are two opposing trends from domestic and international sources. Continued inflationary pressures are expected to come from the domestic economy, where strong growth is anticipated to continue running up against capacity constraints, leading to increased pricing power on the part of suppliers. This will be exacerbated by the increase in Government expenditure – both from the ongoing Budget as well as from increased utilization of funds from trust.

On the other hand, the international drivers of inflation, which until recently had been adding to inflationary pressures, have reversed sharply. The appreciation of the Kina, particularly against the Australian dollar, combined with recent sharp falls in most commodities, such as oil, rice and flour can be expected to reduce inflationary pressures in the economy.

The extent to which this dampens inflation will be determined by the degree in which lower import prices are passed onto end users. While in some cases, such as fuel, these prices are being passed on relatively quickly, the strength of the domestic economy and lack of competitive pressure in many sectors may lead to higher margins rather than lower prices. Nonetheless, the international factors do mean that there is likely to be reduced pressure on prices.

Figure 5: Headline and Underlying 1990-2008



Source: National Statistical Office

In reaction to the higher inflationary environment, monetary policy has tightened slightly, with the Bank of PNG increasing the Kina Facility Rate (KFR) by 50 basis points in September 2008 from 6.5 per cent to 7 per cent. The Kina has also appreciated significantly, with the Trade Weighted Index up 41 per cent over the past year. Nonetheless, there is room for further monetary tightening, given the very high rates of inflation, the high rates of money and credit growth, negative real interest rates and the strong growth in the economy.

Given the current economic situation, both monetary and fiscal policy must operate in a coherent manner in order to prevent higher inflation being built into peoples' expectations, which could result in a wage price spiral and threaten the macroeconomic stability that has been the foundation of the strong economic growth experienced over recent years.

1.5 MONETARY DEVELOPMENTS

Monetary conditions remained relatively loose in 2008. Liquidity in the economy has been building over the last three years, reflected by a trend of increasing money supply and credit growth – both have increased at higher rates of 30 and 40 per cent respectively through the year to September 2008 (Figure 6).

Figure 6: Money Supply& Credit Growth

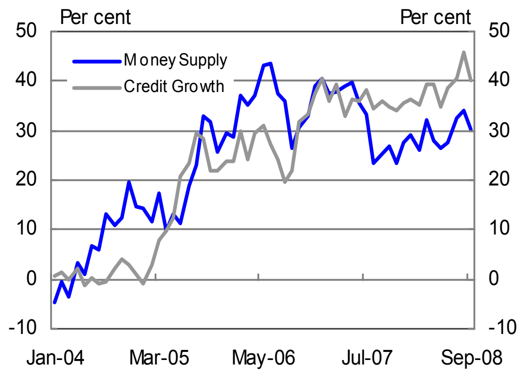
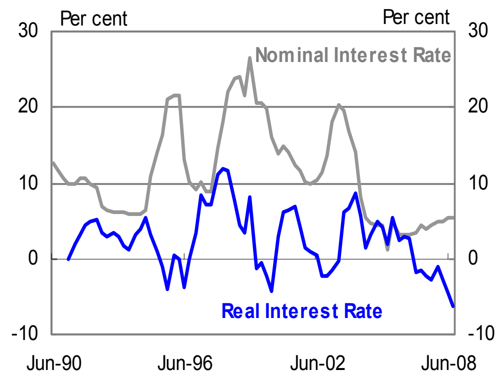


Figure 7: Nominal Vs Real interest Rates



Source: Bank of PNG

While increasing the money supply growth can support an economy with large amounts of spare capacity, it tends to adds to inflationary pressures when the economy is growing strongly and facing capacity constraints.

The Bank of PNG has moved to tighten monetary conditions marginally with two 25 basis points increases in June and August and one 50 basis point increase in the Kina Facility Rate in September – a cumulative 100 basis points adjustment, increasing the KFR from 6 per cent to 7 per cent in 2008. This is aimed at slowing the economy in order to reduce inflationary pressures.

Despite this, the increased rate of inflation means that the real interest rate – the cost of borrowing once inflation is taken into account – is significantly negative (Figure 7) hence proving very accommodative to further private sector investment.

Monetary Policy is the key tool in maintaining price stability and it is appropriate that it be monitored closely and adjusted to reflect current and expected circumstances.

1.6 BALANCE OF PAYMENTS AND INTERNATIONAL PRICES

In 2008, the current account balance is expected to be a surplus of K1,880 million (8.7 per cent of GDP), which is substantially higher than the 2007 surplus of K366 million. The higher surplus is due to a large increase in export values, which are expected to increase by more than import values.

In the first half of 2008, the current account balance recorded a surplus of K1,149 million, which is higher than the surplus of K570 million recorded in the corresponding period of 2007.

The value of exports in 2008 is expected to increase by 12 per cent from 2007, reflecting increased volumes of agriculture and mineral exports due to increased production, and significantly higher world prices for most exports. While prices have fallen dramatically in the second half of the year, prices are still expected to be higher on average in 2008 than in 2007.

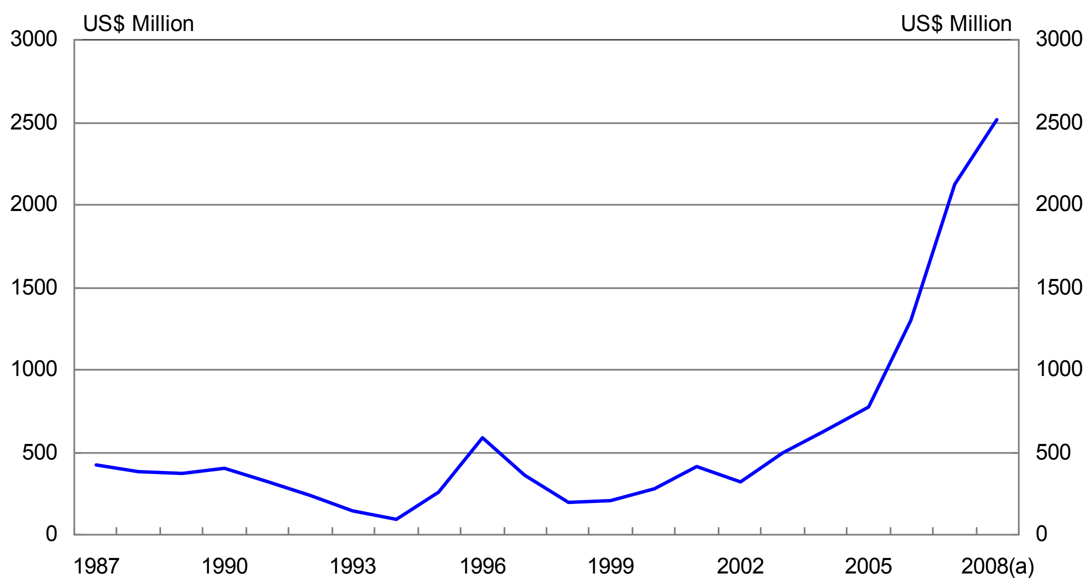
The value of imports is expected to increase in 2008, reflecting imports for the construction work on the Ramu Nickel project, offset by lower import volumes from a number of other projects, such as Lihir, which completed the construction and commissioning of it's process plant and geothermal expansion in 2007. Other goods and services imports are expected to have remained at high levels in 2008, in line with continued strong domestic demand.

The Income deficit is expected to have widened in 2008, due to increasing dividend outflows, reflecting the increased profitability of mineral projects caused by higher commodity prices, as well as strong non-mineral profits. This is partly offset by increased inflows of project grants, which increased the Transfers surplus.

The Capital and Financial Accounts recorded a deficit of K1,205 million in the first half of 2008. This implies a net outflow of capital from the PNG economy, which largely reflects a build up in foreign reserves by the Bank of PNG which increased by K400 million in the first half of 2008. In the full year of 2008, the capital and financial accounts is expected to record a deficit of K1,880 million, higher than the deficit of K411 million in 2007.

The holdings of gold and foreign exchange reserves by Bank of PNG at the end of July 2008 were K6,290.9 million (US$2,428.3 million). This very high level of reserves is more than sufficient to perform the role of managing short term exchange rate volatility.

Figure 8: Foreign Reserves US Dollar Millions



(a) Includes reserve levels to end of July, 2008.

1.7 EXCHANGE RATE DEVELOPMENTS

The exchange rate has appreciated significantly against most currencies in 2008, reversing a slight trend depreciation over the previous three years (Figure 9). The import Trade Weighted Index appreciated 33 per cent over the year to October 2008, and has appreciated by 10 per cent against the US dollar, 51 per cent against the Australian dollar, 24 per cent against the Euro. The Kina has depreciated by 6 per cent against the Japanese Yen.

The appreciation against the US dollar is a reflection of the very high rates of mineral revenues received by the Government in the form of tax revenues and dividend payments. The second major factor driving the appreciation of the Kina on a trade weighted index basis has been the large and rapid depreciation of the Australian dollar, which has depreciated sharply against most currencies as a direct result of the global financial crisis. The Kina has now appreciated by an unprecedented 42 per cent against the Australian dollar since July 2008.

Overall, the sharp appreciation of the Kina (to the extent that it is maintained) is likely to have some major impacts on the PNG economy. It is likely to introduce some reduced inflationary pressures, which will be useful in the current high inflation environment. At the same time, it will reduce the competitiveness of PNG export and import competing sectors, and/or reduce the Kina value of export earnings, at a time when export prices, of both mineral and agricultural prices, are falling sharply. This will dampen domestic demand, through a reduction of producers' incomes, as well as through reduced Government tax revenues.

The appreciation will also encourage increased imports, particularly from Australia, which have become 51 per cent cheaper over the past year in Kina terms, at a time when the current account seems likely to switch from a large surplus to a large deficit, on the back of falling export values.

Overall, it seems that some limited appreciation of the Kina was warranted in order to assist in restraining inflationary pressures when the terms of trade was increasing to record levels. However, now that the situation has reversed dramatically, with the terms of trade dropping substantially, the exchange rate should gradually adjust to the new circumstances, and act as a buffer against external shocks, rather than as an amplifier. If the exchange rate moves in the opposite direction to that expected with a terms of trade shock, it could increase the risk of imbalances building in the economy and the risk of a sharp rather than gradual correction.

Figure 9: Exchange Rate Developments

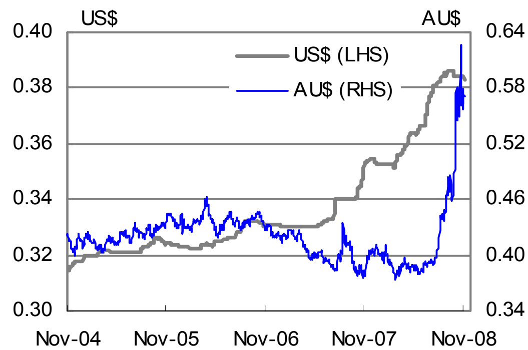
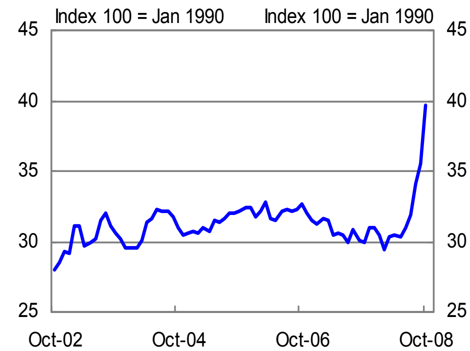


Figure 10: Import Weighted Trade Weighted Index

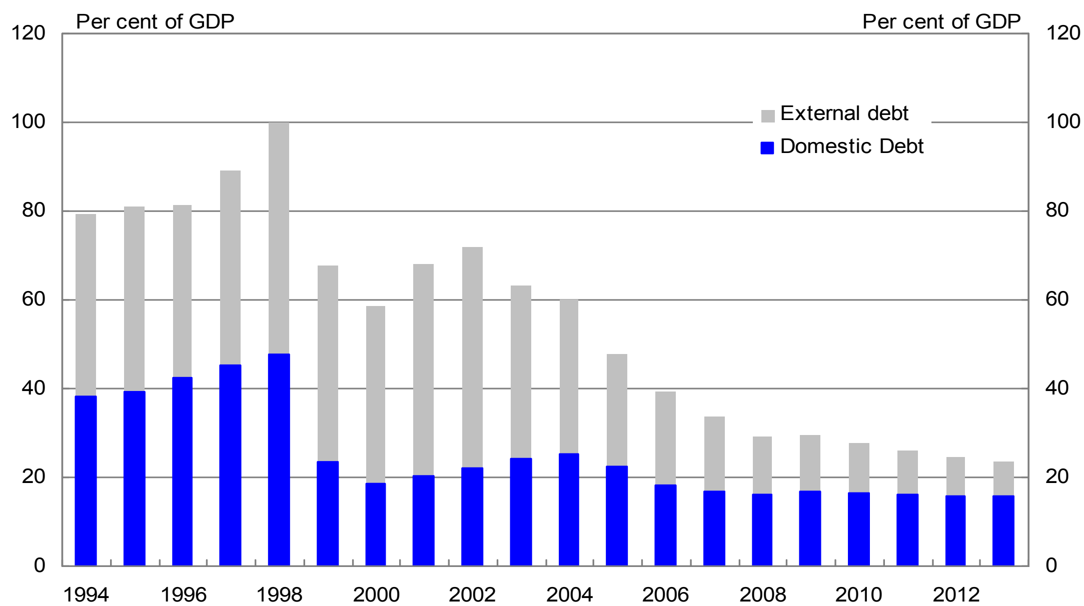


Source: BPNG

1.8 PUBLIC DEBT

Total Public debt has fallen from 72 per cent of GDP or K8,365.3 million in 2002 to 33.8 per cent of GDP or K6,319.0 million at the end of 2007. By the end of 2008, total public debt is expected to fall to 28.8 per cent of GDP or K6,217.2 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 the recent adverse economic and financial developments, as demonstrated recently.

Figure 11: Public Debt 1994-2013 (Per cent of GDP)



Source: Department of Treasury

1.8.1 Domestic Debt

At the end of 2007 the stock of domestic debt was K3,173.3 million, an increase of K72.3 million or 2.3 per cent over a year earlier. The stock of domestic debt at the end of 2008 is expected to be K3,474.0 million, an increase of K300.7 million or 9.5 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 2008 expected to be comprised of 30.3 per cent Treasury Bills, 69.3 per cent Inscribe Stock and 0.4 per cent Other Domestic Loans.

1.8.2 External Debt

Total external debt at the end of 2007 was K3,146.0 million. This represented a decline of K485.1 million or 13.4 per cent from the level at the end of 2006. This decline in external debt has continued in 2008, falling by 11.7 percent or K369 million to a projected K2,777 million by year end.

The decline in external loans reflects the Government's strategy of increasing the percentage of debt issued domestically, to reducing the share of external or foreign currency debt. This has helped to shield the PNG economy from some of the worst of the financial crises in 2008.

Project loan draw downs are expected to be K163 million in 2008 while principal repayments of external debt is estimated to be K456 million.

External debt continues to be dominated by debts to international agencies (multilateral and bilateral creditors) who account for 96.6 per cent of external debts as at year- end 2007, with commercial loans accounting for the remaining 3.4 per cent.

1.9 CENTRAL GOVERNMENT FISCAL OPERATIONS

The fiscal outcome for 2008 is now projected to be a budget deficit of K9.5 million, effectively a balanced budget when measured as a percentage of GDP, compared with the original surplus estimate of K202.4 million or 1.0 per cent of GDP.

Table 2: Budget Balance 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Total Revenue and Grants	7028.6	7201.6	7780.4	+578.8
Total Expenditure and Net Lending	6552.4	6999.2	7789.9	+790.7
Deficit (-)/Surplus(+)	**476.2**	**202.4**	**-9.5**	**-211.9**
Per cent of GDP	2.5%	1.0%	-0.0%	

Source: Department of Treasury

Since the 2008 Budget, there has been upward to upward revisions to both the revenue and expenditure side in 2008, as a result of the higher than anticipated commodity prices and the 2008 Supplementary Budget passed in September of 2008.

However, there has been a significant downward revision from the revenue estimates in the Mid Year Economic and Fiscal Outlook (MYEFO), which was released in July 2008. This was caused by the collapse in commodity prices in the latter half of 2008. There are also early indications that revenue may potentially be lower than the current estimate, due to continued declines in commodity prices below the current projections, which are likely to impact on the third and final installment of Mining and Petroleum Tax payments.

1.9.1 Total Revenue and Grants

Total Revenue and Grants for 2008 are estimated to be K7,780.4 million, an increase of K578.8 million or 8.0 per cent from the 2008 Budget projection of K7,201.6 million.

Table 3: Tax Revenue 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Taxes on Income and Profits	4491.3	4142.0	4659.1	+517.1
Dom. Taxes on Goods & Services	958.5	987.3	1031.7	+44.1
Taxes on International Trade	404.2	387.4	425.4	+38.0
Tax Revenue	**5854.0**	**5516.7**	**6116.2**	**+599.5**

Source: Department of Treasury

Tax revenue is now expected to be K6,116.2 million, K599.5 million or 10.9 per cent higher in 2008 than the Budget projection of K5,516.7 million. The increase in tax revenue largely reflects substantially higher than expected taxes on income and profits.

Table 4: Taxes on Income and Profits 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Personal Income Tax	1006.9	1053.7	1086.2	+32.5
Company Tax	723.7	699.7	778.2	+78.8
Dividend Withholding Tax	199.3	195.5	196.8	+1.3
Mining and Petroleum Taxes	2333.9	2011.8	2392.2	+380.4
Interest Withholding Taxes	19.3	21.4	21.1	-0.3
Other Direct Tax	111.2	86.5	93.1	+6.6
Gaming Tax	97.0	73.4	91.6	+18.2
Taxes on Income and Profits	**4491.3**	**4142.0**	**4659.1**	**+517.1**

Source: Department of Treasury

Tax on income and profits is now expected to be K4,659.1 million in 2008, K517.1 million or 12.5 per cent higher than the level expected in the 2008 Budget. Personal income tax is expected to increase by K32.5 million over the 2008 Budget estimate to K1,086.2 million in 2008, mainly due to higher than normal arrears collections. Company tax collections are expected to be stronger than expected at the time of the 2008 Budget, reflecting an increase in economic activity and profitability for businesses. Dividend Withholding Taxes remained at elevated levels relative to historical levels and mainly reflects payments for major commodity exports.

Mining and Petroleum Taxes are expected to be K380.4 million or 18.9 per cent higher than the 2008 Budget projection. However, this is a significant downward revision from the MYEFO estimate of K3,049 million, which was made as commodity prices reached record levels. Since the MYEFO was released, commodity prices have fallen sharply and the Kina has appreciated significantly. There has also been significant hedging losses from one of

the joint owners of several major oil fields, which is affecting revenue accrued in 2008, as well as previously expected arrears payments from 2007.

Given these factors, and early indications of weak collections during the third and final installment of Mining and Petroleum Taxes, the potential exists for a further downward revision to Mining and Petroleum Taxes in 2008.

Interest Withholding Tax remains close to the level expected in the 2008 Budget. Other direct taxes in 2008 are now expected to be K6.6 million (7.6 per cent) more than the 2008 Budget forecast, reflecting stamp duty on a share transfer in the middle of the year, while gaming tax is expected to come in higher, in line with increased economic activity.

Table 5: Domestic Taxes on Goods and Services 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Excise	342.0	368.3	370.2	+1.9
GST	557.5	600.8	646.1	+45.3
Mining Levy	56.6	15.0	12.0	-3.0
Other Indirect	2.4	3.2	3.3	+0.1
Domestic Taxes on Goods & Services	**958.5**	**987.3**	**1031.7**	**+44.4**

Source: Department of Treasury

Domestic taxes on goods and services are now expected to be K1,031.7 million in 2008, K44.4 million higher than forecast in the 2008 Budget. 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 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Import Duty	135.9	132.7	149.9	+17.2
Export Duty	155.2	155.2	152.0	-3.2
Excise Duty on Imports	113.1	99.5	123.5	+24.0
Taxes on International Trade	**404.2**	**387.4**	**425.4**	**+38.0**

Source: Department of Treasury

Taxes on international trade are now projected to be K425.4 million in 2008, which is K38.0 million or 9.8 per cent more than originally expected. Import duty will raise K17.2 million more than expected in 2008. This is due to the 2007 base being stronger than expected and stronger than expected domestic demand resulting in higher imports.

Export duty on logs is expected to be K152.0 million in 2008, down K3.2 million from the 2008 Budget estimate. The main driver is the lower production of logs in the first half of the year as a result of seasonal conditions.

Excise duty on imports are now expected to be K123.5 million in 2008, K24.0 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 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Property Income	312.7	388.3	376.5	-11.8
Non-Mining Dividends	*87.0*	*128.5*	*140.0*	+11.5
Mining & Petroleum Dividends	*225.7*	*259.8*	*236.5*	-23.3
Interest and Fees from Lending	0.5	5.0	9.0	+4.0
Other Non Tax Revenue	119.8	94.2	93.7	-0.5
Total Non Tax Revenue	**433.0**	**487.5**	**479.3**	-8.2

Source: Department of Treasury

Non-tax revenue is estimated to be K479.3 million in 2008, K8.2 million or 1.7 per cent lower than expected at the time of the 2008 Budget. The decrease is attributable to lower mining and petroleum dividends and property income, partially offset by higher non-mining dividends.

Non-Mining Dividends are expected to be K11.5 million or 8.9 per cent higher than anticipated, whilst Mining Dividends are expected to be K236.5 million, which is K23.3 million or 8.9 per cent lower than expected in the 2008 Budget. This is due to increased amounts of reinvested earnings from Ok Tedi, which will be used to fund cost overruns on the Mine Waste Tailings project and to provide a self financing funding facility to the mine.

In 2008, expected Dividend payments from non-mining State assets are: K50 million from the Independent Public Business Corporation, compared to the K25 million expected in the 2008 Budget; K10 million from the National Fisheries Authority, compared to the expected K23.5 million; and K80 million from the Bank of PNG, unchanged from the 2008 Budget estimate.

Interest and fees from lending is expected to be K9.0 million, K4 million higher than the 2008 Budget. Departmental revenue is estimated at K93.7 million which is K0.5 million lower than anticipated.

Both Infrastructure tax credits (ITC) and Project Grants have been revised downwards. ITC has been revised downwards by K3.7 million to K70.0 million due to lower utilization, and project support grants are expected to be K1,095.8 million, down by K15.4 million as a result of the appreciation of the Kina against the currencies of most major donors.

Total revenue and grants are now anticipated to be K7,780.4 million in 2008.

1.9.2 Total Expenditure and Net Lending

Total Expenditure and Net Lending in 2008 is now projected to be K7,789.9 million, an increase of K790.7 million or 11.3 per cent on the 2008 Budget estimate of K6,999.2 million.

Expenditure in 2008 is substantially higher than the original 2008 Budget appropriation due to the Government's decision to apply stronger than expected revenue to priority expenditure areas through the 2008 *Supplementary Budget.*

Table 8: Total Expenditure and Net Lending 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Recurrent Expenditure	3498.0	3636.1	3639.3	+3.2
Development Expenditure	1327.6	1887.1	1874.6	-12.5
Additional Priority Expenditure	1726.8	1476.0	2276.0	+800
Total Expenditure and Net Lending	**6552.4**	**6999.2**	**7789.9**	+790.7

Source: Department of Treasury

1.9.2.1 Recurrent Expenditure

The overall recurrent expenditure in 2008 is estimated to be K3,639.3 million, slightly higher than expected in the 2008 Budget, reflecting slightly higher than anticipated expenditure on personal Emoluments, due to a number of pay increases awarded during 2008, which is expected to be partially offset by lower interest expenditure, due to lower than anticipated debt levels over the course of 2008.

Table 9: Recurrent Expenditure 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Personal Emoluments	1456.3	1528.9	1546.9	+18.0
Goods and Services	1387.1	1456.9	1457.2	+0.3
Interest Payments and Fees	370.1	373.5	358.2	-15.3
Gas Project Acquisition				
Transfers to Bougainville	50.0	54.0	54.2	0.2
Transfers to Statutory Institutions	238.6	226.8	226.8	0.0
Net Lending to CSAs	-4.1	-4.0	-4.0	0.0
Supplementary Budget				
Total Recurrent Expenditure	**3498.0**	**3636.1**	**3639.3**	+3.2

Source: Department of Treasury

An amount of K20.0 million was appropriated to Secretary's Advance in the 2008 Budget. The following table sets out the allocations made from the Secretary's Advance from 1 January 2008 up to 15 November 2008.

Table 10: Allocation of funds from the Secretary's Advance in 2008 (Kina Thousand)

Allocations: 2008 Secretary's Advance (Kina,000)		**(K'000)**	**(K'000)**
	Credit	**Debit**	**Balance**
2008 Appropriation	**20,000.0**		**20,000.0**
Reform Task Group-DPM		1,000.0	19,000.0
Australian Prime Ministers visit		3,200.0	15,800.0
Add.Funds to settle Land Lease Payment		534.0	15,266.0
COI-2006 Riot in Honiara-SI		1,000.0	14,266.0
Foreign Policy Review Exercise		91.7	14,174.3
Withdrawal of funds SA 39/08	**534.0**		**14,708.3**
Purchase Replacement Bus		79.0	14,629.3
PNG/China Symposium in June 08		155.0	14,474.3

DSIP Funding (ORD) of NEC Decision		1,656.2	12,818.1
Purchse of GG Support Vehicle		330.0	12,488.1
To cater for 3 add. NEC meetings (PM&NEC)		831.0	11,657.1
ECP Review Team		200.0	11,457.1
National Planning Committee (NEC Dec)		1,470.0	9,987.1
Add. Funds for Secreary's Vehicle(PLGA)		144.0	9,843.1
Kokoda Track Land Owners		200.0	9,643.1
ADB Vice President & IMF E/Director's visit		76.0	9,567.1
6 Regional Workshops to assist the DSIP		192.2	9,374.9
Late President Kabui's funeral costs		700.0	8,674.9
PNG Chancellery - Tokyo		2,900.0	5,774.9
To assist Min. Oil Resources Ltd		200.0	5,574.9
Air Charter costs 10th festival of Arts - Somoa		768.0	4,806.9
GG's Travel Solomon Islands		175.0	4,631.9
Monitoring looming recurrence - Bougainville		100.0	4,531.9
Creation of new act. "Min. Sectoral Committee"		150.0	4,381.9
Assistance to IMR 40th Anniversary		65.0	4,316.9
PNG SINO Trade Sysmposium		145.0	4,171.9
Melanesian-Spear Head Group Sec. - Vanuatu		1,000.0	3,171.9
Reform Task Group-DPM (NEC Dec.36)		500.0	2,671.9
NEC Dec: 102/08 - Tactical Response Unit (Police)		1,000.0	1,671.9
MMI Insurance cover for the Divisional Heads		34.4	1,637.5
To cater for GG's trip to Tonga		342.1	1,295.4
NCC to pay Eastern Highlands Cultural Centre		160.0	1,135.4
Cater for o/s bills and other costs for remain. Mnths.		397.0	738.4
Cater for Public Servants Master's Game		10.0	728.4
Cater for SMC Meeting in Peru		80.0	648.4
Cover short fall in Printing Cost of 2009 Budget Docs		110.0	538.4
To cater for Min's Delegation to China Expo		200.0	338.4
Add. Funding for Min's Del. To China Expo		100.0	238.4
Settle outstanding for MV Buka Princes		71.5	166.9
Cater for Hon. Kapris & delegaton to Melbourne		150.0	16.9
2008 Supplementary budget Replenishment	**12,630.0**		**12,646.9**
To cater for Natonal Museum & Art Gallery's		568.9	12,078.0
Bumbu & Markham Rivers in Morobe (Mitigation Proj)		800.0	11,278.0
Implementation of the NY Policy (NEC Dec 9&15/08)		2,670.0	8,608.0
Reimbursement of Village Court All. To Enga		2,000.0	6,608.0
To meet shortfall in 2008 Budget to MBPG		2,000.0	4,608.0
Cover NHC Audit as per PAC Recommendations		70.0	4,538.0
To cater for D/Prime Minister's trip to Bali		45.5	4,492.5
Additonal funding to NIO		325.0	4,167.5
Replenish NNB funds to settle o/s liabilities		332.5	3,835.0
To cater for Vice Minister's rental bills		140.3	3,694.7
To cater for Panguna Restoration Progam		118.0	3,576.7
To cover emergency fudns for Police operations		2,300.0	1,276.7
Cover Passport Booklets (Immigrations)		521.9	754.8
Assistance for Pipes and Drums (CIS)		100.0	654.8
Outstanding Utility Bills for Dept. of Provincial Affairs		360.0	294.8
PM's commitment for Silver - paralympic		250.0	44.8
Closing Balance as at 15 November 2008			**44.8**

Source: Department of Treasury

1.9.2.2 Development Expenditure

Development expenditure in 2008 is expected to be slightly lower than the 2008 Budget by K12.5 million, due mainly to the appreciation of the Kina which has reduced the Kina value of Grants.

The domestic component which includes GoPNG and the Infrastructure Tax Credits, along with the Loans remain at the original budget levels.

Table 11: Development Expenditure 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Budget	2008 Revised	Change
Domestic Financing	483.2	526.7	526.7	0.0
Grants	721.0	1123.7	1111.2	-12.5
Infrastructure Tax Credits	20.6	73.7	73.7	0.0
Concessional Loans	101.8	163.0	163.0	0.0
Commercial Loans	1.0	0.0	0.0	0.0
Total Development	**1327.6**	**1887.1**	**1874.6**	-12.5

Source: Department of Treasury

1.9.2.3 Additional Priority Appropriation: 2008 Supplementary Budget

Additional Investment/Priority Expenditure in 2008 is expected to be K2,276 million, higher than the K1,476 million estimate in the 2008 Budget. This is due to the 2008 Supplementary Budget in September 2008, which allocated an additional K800 million of expenditure. Further details on the 2008 Supplementary appropriation can be found in Chapter 3 of this document.

Recurrent, Development, Additional Priority Appropriation and the 2008 Supplementary Budget totaled K7,789.9 million estimated in expenditure for the fiscal year 2008.

1.9.3 Financing

A fiscal deficit of K9.5 million is expected in 2008, effectively a balanced Budget when measured as a percentage of GDP. This compares to the original budget surplus estimate of K202.4 million, or 1 per cent of GDP. This will be financed through Domestic Market Borrowing of K302.7 million and external financing of minus K293.2 million.

CHAPTER 2. 2009 BUDGET

2.1 OVERVIEW

Over recent years, the economy has benefited from strong economic conditions. However, over the last year, the global economy has weakened and has experienced the most severe financial crisis since the 1930s Great Depression. PNG will not be immune from any major global downturn in 2009.

In order to shield the economy from the worst of the impacts of this crisis, the 2009 Budget is designed to maintain confidence by being fiscally prudent and responsible given the circumstances, while providing for increased development expenditure to help support economic growth in rural areas.

The deteriorating global outlook is expected to lower domestic economic growth from 7.2 per cent in 2008 to 6.2 per cent in 2009. The key driver of this lower forecast is the significant fall in commodity prices.

Table 12: Key Economic Assumptions 2007 – 2009

	2007 Actual	2008 Estimate	2009 Projection
Real GDP Growth	6.5	7.2	6.2
Real Non-Mining GDP Growth	7.3	7.9	5.6
Inflation (year average)	0.9	10.6	6.1
Oil Price (USD/Barrel)	72.3	102.0	55.0
Copper Price (USD/Pound)	3.2	3.2	1.5
Gold Price (USD/ounce)	697.0	863.0	600.0
Interest Rates (Treasury Bills)	5.0	6.5	7.0

Source: Department of Treasury

The weaker international economic outlook and commodity prices in 2009 will have direct impact on forecast revenue, with total revenue and grants forecast to be K6,666.4 million, an K1,114.0 million, or 14.3 per cent, reduction from the 2008 estimate. Consistent with the MTFS framework and the need to promote macroeconomic stability and fiscal sustainability in these uncertain times, the Government has lowered it's expenditure and net lending to be K6,676.7 million in 2009, K1,113.2 million, or 14.3 per cent lower than forecast in 2008. As a result, the 2009 Budget is effectively balanced, with a very small deficit of K10.3 million or 0.0 per cent of GDP.

Table 13: Budget Balance 2007 - 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Total Revenue and Grants	7028.6	7780.4	6666.4	-1114.0
Total Expenditure and Net Lending	6552.4	7789.9	6676.7	-1113.2
Budget Balance	**476.2**	**-9.5**	**-10.3**	**-0.8**
Per cent of GDP	2.5%	0.0%	0.0%	

Source: Department of Treasury

2.2 FISCAL STRATEGY

The 2009 Budget has been framed against a background of the international financial crisis and rapidly slowing world economic growth. Despite the collapse in additional mineral revenue, the budget is expected to be balanced, however, there are major uncertainties surrounding the 2009 growth forecast and commodity price assumptions.

The 2009 Budget will be guided by the medium term frameworks which include the Medium Term Development Strategy (MTDS), Medium Term Debt Strategy (Debt Strategy) and the new Medium Term Fiscal Strategy 2008-2012 (MTFS).

The 2009 Budget is the first annual budget to be delivered since the Government's endorsement of its new MTFS. The MTFS has been designed to provide a stable, responsible and prudent framework for the Government to manage its fiscal resources and promote macroeconomic stability over the medium term.

The new MTFS is detailed in Chapter 9. Importantly, the MTFS contains three key fiscal rules to ensure macroeconomic stability, and four principles to guide the use of any additional revenue. These are set out in Box 3.

Box 3: Fiscal Rules & Principles in the MTFS (2008- 2012)

The MTFS will assist the Government in achieving the National Goals in the Constitution and the objectives of the MTDS. There are three key fiscal rules:

- Keep ongoing expenditure in line with normal revenues, which is defined as all non-mineral revenues plus mineral revenue equal to 4 per cent of GDP that can be reasonably expected to be collected if commodity prices fall to long-run levels;
- Use the additional mineral revenue to pre-fund public investment projects and repay debt and other liabilities, using a 70:30 split between the two uses as a guide; and
- Limit the actual amount of public investment expenditure sourced from the additional revenues in any given year to 4 per cent of GDP, in order to promote macroeconomic stability and avoid inflationary pressures.

The strategy lays out four principles to guide the allocation of additional mineral revenues. The use of these revenues should:

- benefit future generations;
- be flexible, in case the additional revenues do not materialize;
- be made while considering the impact on domestic and import demand; and
- be compared to and assessed against all other potential investment projects.

The strategy complies with the *Fiscal Responsibility Act (2006),* which limits the Government to keep the level of public debt below the level at the beginning of the term. This limit on borrowing does not apply to investment projects by State-Owned Enterprises (SOEs) which are supposed to fund themselves, and investment projects with funding arrangements fully independent of the State.

In light of the forecast reduction in revenue arising from lower commodity prices, there will be no Additional Mineral Revenue in 2009. The Government will instead fund its planned expenditure using tax revenue and funds that were previously set aside in the Gas Project Equity Account.

Although inflation is expected to fall in 2009 from the uncomfortably high levels experienced in 2008, there are still strong inflationary pressures coming from within the domestic economy. Inflationary risks include:

- Higher government expenditure from the 2009 Budget and the recent 2008 Supplementary Budget and draw downs from trust accounts.
- Wage outcomes not supported by productivity, including potential outcomes arising from recommendations of the Minimum Wages Board.
- Ongoing growth in money supply and credit.
- Continued expansion in the private sector due to improved business confidence, relatively low interest rates and high profitability.

The Government remains committed to pursing its development policies and the seven priority areas identified in the Medium Term Development Strategy (MTDS). This allows clear signals to be sent to donors and the public 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 and “***Promoting Sustained Economic Growth by Empowering and Transforming the Rural Economy”.***

The 2009 Budget will continue to ensure a substantial allocation of the Government’s own resources to these development priorities. However, the 2009 Budget has not met the MTDS priority spending targets, with 48.7 per cent of GoPNG expenditure in the recurrent and development Budgets going towards the MTDS priorities, compared to the target of 55.5 per cent; and 73.6 per cent of GoPNG funded Development expenditure, compared to the target of 82.7 per cent.

The 2009 Budget is based on the existing tax structure and does not propose any new taxes or tax increases.

2.3 REVENUE AND GRANTS

Total Revenue and Grants for 2009 are projected to be K6,666.4 million. This is K1,114.0 million below the revised 2008 estimate. The major factor behind this substantial downward revision is the large decline in the prices of PNG’s major export commodities, partially offset by a one-off injection of funds from the Gas Equity Trust Account.

Table 14: Revenue and Grants 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Tax Revenue	5854.0	6116.2	4614.3	-1501.9
Non-Tax Revenue	433.0	479.3	1037.8	558.5
Infrastructure Tax Credits	20.6	73.7	40.0	-33.7
Project Support Grants	721.0	1111.2	974.3	-136.9
Total Revenue and Grants	**7028.6**	**7780.4**	**6666.4**	**-1114.0**

Source: Department of Treasury

2.3.1 Tax Revenue

Tax revenue is projected to decrease by a substantial K1,501.9 million or 24.6 per cent to K4,614.3 million in 2009, compared with the K6,116.2 million estimated for 2008.

Table 15: Tax Revenue 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Taxes on Income and Profits	4491.3	4659.1	3043.9	-1615.2
Dom. Taxes on Goods & Serv	958.5	1031.7	1114.2	82.5
Taxes on International Trade	404.2	425.4	456.2	30.8
Tax Revenue	**5854.0**	**6116.2**	**4614.3**	**-1501.9**

Source: Department of Treasury

The major decline is expected from Taxes on Income and Profits which is projected to fall by K1,615.2 million or 34.7 per cent. This is partly offset by the increased revenue from Domestic Taxes on Goods and Services and Taxes on International Trade, which are expected to increase by K82.5 million or 8.0 per cent, and K30.8 million or 7.2 per cent respectively.

Table 16: Taxes on Income and Profits 2007 – 2008 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Personal Income Tax	1006.9	1086.2	1195.1	108.9
Company Tax	723.7	778.2	877.3	99.1
Dividend Withholding Tax	199.3	196.8	144.2	-52.6
Mining and Petroleum Tax	2333.9	2392.2	626.5	-1765.7
Interest Withholding Taxes	19.3	21.1	19.1	-2.0
Other Direct Tax	111.2	93.1	85.8	-7.3
Gaming Tax	97.0	91.6	95.9	4.3
Taxes on Income and Profits	**4491.3**	**4659.1**	**3043.9**	**-1615.2**

Source: Department of Treasury

Taxes on Income and Profits are expected to be K3,043.9 million in 2009. This is K1,615.2 million lower than the revised estimate of K4,659.1 million for 2008. The decline is reflected in Mining and Petroleum Taxes which are estimated to fall by K1,765.7 million or 73.8 per cent. This reflects the substantial decline in commodity prices and appreciation of the exchange rate.

Personal Income Tax receipts are expected to increase by K108.9 million or 10.0 per cent to K1,195.1 million in 2009 compared with the estimate of K1,086.2 million in 2008. Corporate Income Tax receipts are estimated to increase by K99.1 million or 12.7 per cent to K877.3 million in 2009, compared with K778.2 million estimated for 2008. These increases reflect expected solid domestic economic conditions in 2009, with strong profit and employment growth.

Dividend Withholding Tax collections are expected to decrease by K52.6 million or 26.7 per cent to K144.2 million from the 2008 estimate of K196.8 million. The projected decrease reflects the lower expected dividend receipts from Ok Tedi in 2009 as a higher proportion of profits are expected to be retained for capital expenditure.

Interest Withholding Tax receipts are projected to decrease by K2.0 million or 9.5 per cent to K19.1 million in 2009 compared with K21.1 million estimated in 2008.

Other Direct Tax receipts are expected to decline by K7.3 million or 7.8 per cent to K85.8 million in 2009 in line with the full year impact of cuts to stamp duties announced in the 2008 Budget, which only began in March 2008. Gaming Tax is projected to increase by K4.3 million or 4.7 per cent to K95.9 million in 2009 compared with the K91.6 million estimated in 2008.

Table 17: Domestic Taxes on Goods & Services 2007–2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Excise	342.0	370.2	407.5	37.3
GST	557.5	646.1	703.0	56.9
Mining Levy	56.6	12.0	0.0	-12.0
Other Indirect	2.4	3.3	3.7	0.4
Domestic Taxes on Gds & Serv	**958.5**	**1031.7**	**1114.2**	**82.5**

Source: Department of Treasury

Domestic Taxes on Goods and Services are expected to increase by K82.5 million or 8.0 per cent in 2009 to K1,114.2 million compared with K1,031.7 million estimated in 2008.

Domestic excise collections are expected to increase by K37.3 million or 10.1 per cent to K407.5 million in 2009 compared with the estimate of K370.2 million in 2008. The National Government's share of Goods and Services Tax (GST) is expected to increase by K56.9 million or 8.8 per cent to K703 million in 2009 compared with the estimate of K646.1 million in 2008. This is due to increased economic activity. The Mining Levy has been phased out in 2008; hence no revenue is expected in 2009.

Table 18: Taxes on International Trade 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Import Duty	135.9	149.9	166.3	16.4
Export Duty	155.2	152.0	152.9	0.9
Excise Duty on Imports	113.1	123.5	137.0	13.5
Taxes on International Trade	**404.2**	**425.4**	**456.2**	**30.8**

Source: Department of Treasury

Collections from Taxes on International Trade are expected to increase by K30.8 million or 7.2 per cent in 2009 to K456.2 million compared with the 2008 estimate of K425.4 million. This is due to increased economic activity.

Import Duty receipts are expected to increase by K16.4 million or 10.9 per cent to K166.3 million in 2009 compared to the 2008 estimate of K149.9 million. Export Duty on logs is projected to increase by K0.9 million or 0.6 per cent to K152.9 million in 2009 compared with the 2008 estimate of K152.0 million. Excise Duty on Imports is projected to increase by K13.5 million or 10.9 per cent to K137.0 million in 2009 compared with an estimated K123.5 million in 2008.

2.3.2 Non-Tax Revenue

Table 19: Non Tax Revenue 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Property Income	312.7	376.5	322.9	-53.7
Non-Mining Dividends	*87.0*	*140.0*	*195.0*	55.0
Mining & Petroleum	*225.7*	*236.5*	*127.9*	-108.7
Injection from Trust Accounts	0.0	0.0	600.0	600.0
Interest & Fees from Lending	0.5	9.0	24.0	15.0
Other Non Tax Revenue	119.8	93.7	90.9	-2.8
Non Tax Revenue	**433.0**	**479.3**	**1037.8**	**558.5**

Source: Department of Treasury

Non-Tax Revenue receipts are projected to increase by K558.5 million or 116.5 per cent in 2009 to K1037.8 million compared with an estimated K479.3 million in 2008.

The large increase in Non-Tax Revenue is due to the injection of K600.0 million of funds from the Gas Equity Trust Account. This will be used to fund one-off expenditure in 2009.

Property Income is projected to decline by K53.7 million or 14.2 per cent to K322.9 million in 2009 compared with the 2008 estimate of K376.5 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 higher retained earnings for capital expenditures expected in 2009. The projection of K127.9 million in mining dividends is expected to come from the following: OTML K117.9 million and Petromin K10.0 million. The projection of K195.0 million in non-mining dividends is based on the expected receipt of dividends in 2009 from the Bank of Papua New Guinea (K70.0 million), National Fisheries Authority (K25.0 million) and the Independent Public Business Corporation (K100.0 million).

Interest and Fees from Lending is projected to increase by K15.0 million in 2009 to K24.0 million compared with the 2008 estimate of K9.0 million. This largely reflects higher expected interest revenue from the Government's trust accounts. Other Non-Tax Revenue, reflecting revenue from departments, is projected to decline by K2.8 million to K90.9 million in 2009 from the K93.7 million estimated for 2008.

2.3.3 Infrastructure Tax Credits

Infrastructure tax credits (ITC) are expected to decline from K73.7 million in 2008 to K40.0 million in 2009. This is a reduction of K33.7 million or 45.7 per cent and reflects reduced utilization of ITC as well as lower revenues, which ITC entitlements are based on.

2.3.4 Grants

Project Support Grants for 2009 are expected to decline by K136.9 million to K974.3 million from the estimated level of K1,111.2 million in 2008. The projected decrease reflects the appreciation of the Kina against major currencies, particularly against the Australian dollar.

Table 20: Grants by Source (Kina Millions)

	2008 Estimate	2009 Projection	Change	% Change
AusAID	833.6	699.3	-134.3	-16.1
JICA	212.8	139.6	-73.2	-34.4
European Union (EU)	29.8	19.2	-10.6	-35.6
New Zealand	51.9	48.4	-3.5	-6.8
China	33.7	21.4	-12.3	-36.4
United Nations (UN)	13.6	0.0	-13.6	-100.0
Others	31.6	40.0	8.4	26.4
Total Project Grants	**1207.0**	**967.9**	**-239.1**	**-19.8**

Source: Department of National Planning and Monitoring

2.4 EXPENDITURE

Total Expenditure and Net Lending is projected to be K6,676.7 million in 2009, which is K1,113.2 million or 14.3 per cent lower than the expected 2008 Budget outcome.

The total Recurrent Budget has been increased by K265.3 million or 7.3 per cent and the Development Budget has been increased by K720.5 million or 38.4 per cent in 2009.

Table 21: Total Expenditure and Net Lending 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Recurrent Expenditure	3498.0	3639.3	3904.5	265.3
Development Expenditure	1327.6	1874.6	2595.2	720.5
Reappropriation into Trust Account	0.0	0.0	177.0	177.0
Additional Priority Expenditure	1726.8	2276.0	0.0	-2276.0
Total Expenditure and NL	**6552.4**	**7789.9**	**6676.7**	**1113.2**

Source: Department of Treasury

2.4.1 Additions to recurrent expenditure

The 2009 Recurrent Budget provides for major increases to various key priority areas including individual Government agencies. Major funding increases include:

<u>Increased funding to individual agencies</u>

Increased funding will be provided to a number of individual agencies for specific projects and to meet increased personnel and operating costs. Major increases are being provided to Provincial Governments (K119.6 million), Hospital Management Services (K46.2 million), Education (K14.7 million), Internal Revenue Commission (K10.1 million), Transport (K6.2 million), Defence (K13.6 million), and the Office of Climate Change and Carbon Trading (K5 million).

<u>One-Off Government Expenditures</u>

The 2009 Budget is providing an additional K58 million to fund a series of important one-off Government expenditures including a contribution to the Motu-Koita Assembly (K10 million), assistance to Milne Bay Provincial Government and the Western Highlands Provincial

Government following the destruction of Provincial offices (K13 million), Madang Marine Park (K10 million), the National Gaming Control Board (K5 million), Independence Scholarships (K5 million), Free Trade Zone (K5 million), Mirigini Haus (K4 million), the Women in Parliament initiative (K2.5 million), consultancy for a Nambawan Superannuation review (K2 million), Massim Cultural Foundation (K1 million) and funding for scoping work for a possible PNG team in the Australian National Rugby League (K0.5 million).

Funding for specific road maintenance
K50 million will be provided for maintenance of the nation's priority roads, as identified in the National Transport Development Plan. This increased funding will enable the Department of Works to undertake additional routine and specific maintenance on over half of the 4,200 kilometers of priority roads.

Air Niugini Capital Injection
Air Niugini will be provided with a K30 million capital injection in 2009 to assist Air Niugini to meet costs associated with refleeting and other operational issues.

LNG Project Support Funding
To support the LNG Project, K20 million will be provided in 2009 to meet the operating costs of the LNG Project Support office.

Establishment & operation of the National Television Service
The 2009 Budget includes K7 million in addition to the K12 million provided in the 2008 Supplementary Budget for the continued rollout and ongoing operations of the recently established National Television Service.

Other major expenditures
Other major items announced in the 2009 Budget include new funding for the Civil Aviation Authority (K33.0 million), Oro Restoration Authority (K20 million) and National Border Authority (K4.0 million).

2.4.2 Recurrent Expenditure

Total recurrent expenditures are forecast to increase by K265.2 million (7.3 per cent) to K3,904.5 million in 2009 from K3,639.3 million in 2008.

Table 22: Recurrent Expenditure 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Personnel Emoluments	1456.3	1546.9	1603.5	56.6
Goods and Services	1387.1	1457.2	1601.2	144.0
ABG	50.0	54.2	57.0	2.8
Transfers to Staturtory Institutions	238.6	226.8	253.9	27.1
Interest Payments and Fees	370.1	358.2	392.8	34.6
Net Lending to CSAs	-4.1	-4.0	-4.0	0.0
Total Recurrent Expenditure	**3498.0**	**3639.3**	**3904.5**	**265.2**

Source: Department of Treasury

2.4.2.1 Personnel Emoluments

Personnel Emoluments comprise salaries and allowances, wages, overtime, leave fares, superannuation contributions, superannuation pay outs, and contract gratuities. Personnel Emoluments for National Departments and Provincial Government, including Teachers' Salaries

are estimated to increased by K 56.6 million or by 3.7 per cent to K1,603.5 million in 2009 compared to K1,546.9 million in 2008.

There are several factors behind the increase in personnel emoluments in 2009. These include:

- The inclusion of award increases for health workers;
- Increased Teachers' salaries following the signing of a new MOA ; and
- Position upgrades and increased allowances approved by SCMC.

Table 23: Personnel Emoluments 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
National Departments	834.7	945.4	943.7	-1.7
Provincial Governments	621.6	601.5	659.8	58.3
Staffing Grants	*183.6*	*171.0*	*198.7*	*27.7*
Teachers Salaries	*438.0*	*430.5*	*461.1*	*30.6*
Total Personnel Emoluments	**1456.3**	**1546.9**	**1603.5**	**56.6**

Source: Department of Treasury

A summary of personnel emoluments at the National and Provincial level is provided in Table 23. The significant factor behind the overall increase in personnel emoluments in 2009 relates to the K58.3 million or 9.7 per cent increase being provided to Provincial Governments.

Table 24: Personnel Emoluments by Items 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Salaries	603.4	702.4	715.4	13.0
Salaries and Allowances	*536.2*	*613.8*	*624.2*	10.5
Wages	*67.2*	*88.6*	*91.2*	2.6
Superannuation	125.9	136.0	110.0	-26.0
Leave Fares	37.4	44.8	45.5	0.7
Contract Gratuity	3.6	5.0	6.1	1.1
Others 1/	64.4	57.2	66.7	9.5
Total Personnel Emoluments	**834.7**	**945.4**	**943.7**	**-1.6**

Source: Department of Treasury

1/ Includes overtime and contact officers' education benefit

A summary of the components of personnel emoluments is provided in Table 24. The increase in personnel emoluments has been driven by increased salaries and allowances (K10.5 million) and wages (K2.6 million). The decline in superannuation expenditure (K26.0 million) reflects the Government's decision to fund other spending priorities in 2009. This means that the Government is unlikely to be able to fully fund its employer superannuation contribution of 8.4 per cent of salary of Government employees from 2009 onwards.

2.4.2.2 Goods and Services

Total Goods and Services expenditure in 2009 is estimated to be K1,601.2 million. This is K144.0 million or 9.9 per cent higher than the revised estimate for 2008.

Table 25: Goods and Services 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
National Departments	1263.7	1330.4	1420.8	90.4
Provincial Governments	123.4	126.8	180.4	53.6
Total Goods and Services	**1387.1**	**1457.2**	**1601.2**	**144.0**

Source: Department of Treasury

2.4.2.2.1 Goods and Services – National Departments

Total National Departments Goods and Services funding is estimated to be K1,420.8 million in 2009, which is K90.4 million or 11.2 per cent higher than the revised estimate for 2008.

Table 26: National Departments Goods and Services 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
General Goods and Services	1050.8	1084.1	1207.4	123.3
Education Subsidies	148.9	143.0	143.0	0.0
Other Goods and Services	64.0	103.3	70.4	-32.9
Pre-March 2003 Arrears	*1.2*	*0.0*	*0.0*	0.0
Structural Adjustments Program	*6.8*	*51.3*	*18.4*	-32.9
Court Orders	*56.0*	*52.0*	*52.0*	0.0
Total Nat Depts Goods and Serv	**1263.7**	**1330.4**	**1420.8**	**90.4**

Source: Department of Treasury

General Goods and Services expenditure by National Departments is estimated to be K1,207.4 million in 2009, an increase of K123.3 million (or 11.4 per cent) compared with the revised estimate for 2008. The net increase is mainly due to increased allocations to various Departments including National Parliament, Internal Revenue Commission, Police, Education, Hospital Management Services and Works.

Education Subsidies are estimated to remain at K143.0 million for 2009.

Other Goods and Services expenditure in 2009 is estimated at K70.4 million, K32.9 million lower than the revised estimate for 2008. This is due mainly to lower than originally planned numbers of retrenchments which has resulted in a reduced provision for retrenchments and reduced Structural Adjustment Program expenditure.

No appropriation has been made for the pre-March 2003 Arrears as this will need to be addressed by individual departments who have incurred these arrears.

The Government continues to bear financial risks from the awarding of significant damages against the State. The 2009 Budget maintains an allocation of K52.0 million for payment of court orders.

Table 27: General Goods and Services by Item 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Operational Materials and Supplies 1/	95.3	112.6	122.9	10.4
Utilities	104.4	134.3	130.0	-4.3
Rental of Property	97.5	115.8	123.9	8.1
Grants to Individuals and NPO	158.3	72.0	79.6	7.7
Transport and Fuel	45.3	44.0	46.2	2.3
Travel and Subsistence	41.9	47.5	44.5	-3.0
Routine Maintenance	29.4	38.1	36.8	-1.3
Purchase if Vehicles	15.6	18.3	13.1	-5.2
Membership Fees/Contributions	6.5	9.0	9.7	0.7
Other 2/	669.5	738.9	814.1	75.2
Total Nat Depts Goods and Services	**1263.7**	**1330.3**	**1420.8**	**90.5**

Source: Department of Treasury

1/ Includes other operational expenses

2/ Other includes office furniture and equipments, training, administrative consultancy fees

Table 27 summarizes movements in General Goods and Services by item. Major increases are for Office Furniture and Equipment, Training, and Administrative Consultancy fees totaling K75.2 million; Operational Materials and Supplies of K10.4 million, Grants to Individuals and Non Profit Organizations (NPO) of K7.7 million and is offset by small decreases in Routine Maintenance of K1.3 million, Travel and Subsistence of K3.0 million, Utilities of K4.3 million and the Purchase of Vehicles of K5.2 million.

2.4.2.2.2 Goods and Services – Provincial Departments

Goods and services expenditure ceilings for Provinces have been determined on the basis of new funding arrangements for sub-national governments arising from the Review of Intergovernmental Financing Arrangements (RIGFA), which were passed by Parliament in July 2008.

Under the new system, the amount of goods and services funding provided to Provincial and Local-Level Governments, other than the National Capital District and Bougainville, is set at a specified percentage of Net National Revenue (NNR). The system is based on actual revenue data from the year two years before the Budget year (second preceding year), and legislation specifies the proportion of this NNR (or NNR rate) that should be provided. Due to the phased introduction of additional funding into the system, the NNR rate will increase from 5.12 per cent in 2009 to the ongoing rate of 6.57 per cent from 2013. The total pool of funding determined by applying the NNR rate to the second preceding year's NNR is known as the Equalisation Amount.

This "share of NNR" approach ensures that as "normal" revenues rise, funding to Provincial and Local-Level Governments also rises. Conversely, if revenues fall, the grants also reduce so that the system remains affordable. These new arrangements will lead to steady increases in funding for Provinces in 2009 and into the future.

Goods and Services expenditure ceilings for individual Provinces and Local Level Governments for the 2009 Budget were determined on the basis of the fiscal needs of each sub-national government. NEFC determines fiscal need using a 'costs minus revenues' formula, with additional available revenue being directed to those areas where the need is the greatest.

Under the new system, Provinces will no longer receive a derivation grant. However, two new grants will be provided:

- an Agriculture Function Grant for the goods and services costs associated with agriculture and other primary production, including fisheries and forestry; and
- an Other Service Delivery Function Grant for the goods and services costs associated with administering all of the functions assigned to Provinces which are not funded by a specific service delivery function grant. These include business development, community development, natural resource management and lands administration.

Table 28: Provincial Goods and Services Grants 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Unconditional Grants	16.1	15.5	24.3	8.8
Administrative / Block	*16.1*	*15.5*	*24.3*	*8.8*
Conditional Grants	66.9	69.2	125.3	56.0
Health Function	*13.4*	*14.5*	*28.4*	*13.9*
Education Function	*21.6*	*21.7*	*31.6*	*9.9*
Transport Maintenance	*15.4*	*16.7*	*34.0*	*17.3*
Village Court Function	*2.2*	*2.2*	*2.2*	*0.0*
Derivation	*14.3*	*14.1*	*0.0*	*-14.1*
Agriculture Function	-	-	*14,1*	*14.1*
Other Service Delivery	-	-	*14.8*	*14.8*
Other Grants for LLGs	40.4	42.0	45.6	3.7
Urban LLG/Town & Urban Services	*3.0*	*11.1*	*11.9*	*0.8*
Rural LLG	*37.4*	*30.9*	*33.7*	*2.8*
Total Provincial Goods and Serv	**123.4**	**126.8**	**180.4**	**53.6**

Source: Department of Treasury, NEFC

2.4.2.3 Transfers to Autonomous Bougainville Government

The 2008 Budget for the Autonomous Bougainville Government (ABG) established acceptable baselines for all the grants required under the *Organic Law on Peace Building in Bougainville*. Accordingly, the 2009 Budget funding for the ABG has been determined by indexing the 2008 grants as per the requirements of the Organic Law.

Table 29: Transfers to Bougainville 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Police Grant	2.1	2.2	2.3	0.1
Recurrent Grant	47.9	51.8	54.4	2.6
Conditional Grant	0.0	0.3	0.3	0.0
Total Recurrent Grant	**50.0**	**54.2**	**57.0**	**2.8**

Source: Department of Treasury

2.4.2.4 Transfers to Statutory Authorities

The Statutory Authorities' funding will be increased in 2009 by K27.2 million or 12.0 per cent to K253.9 million compared with the revised estimate for 2008.

Table 30: Transfers to Statutory Authorities 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Tertiary Institutions	76.3	84.5	91.0	6.5
UPNG	*30.4*	*32.1*	*33.4*	1.3
University of Technology	*29.0*	*29.9*	*32.0*	2.1
University of Goroka	*11.1*	*11.6*	*12.4*	0.8
University of Vudal	*5.8*	*6.8*	*9.0*	2.1
Legal Training Institute	1.0	1.3	1.5	0.2
PNG Maritime College	2.5	2.7	2.7	0.1
PNG Forest Authority	35.2	24.5	26.0	1.6
Civil Aviation Authority	11.5	12.2	9.6	-2.6
National Broadcasting Commission	13.1	13.8	20.3	6.5
Ombudsman Commission	11.0	11.1	14.0	2.9
Office of Auditor General	11.0	11.2	14.2	3.0
Tourism Promotion Authority	8.1	9.0	9.8	0.9
National AIDS Council	5.4	5.5	5.7	0.3
National Training Council	1.9	2.2	2.5	0.2
PNG Sports Foundation	4.4	2.8	3.2	0.4
Other 1/	57.0	50.0	57.5	7.5
Total Transfers to Stat Authorities	**238.5**	**226.8**	**253.9**	**27.2**

Source: Department of Treasury

1/ Comprises NRI, NEFC, National Narcotic Bureau, Institute of Medical Research, National Youth Commission, IPA, SBDC, NISIT, ICDC, National Museum Authority, National Housing Commission, National Cultural Commission, CCI, FPDA, NARI, NRA, ICCC, CLRC

Table 30 summarizes transfers to Statutory Authorities in 2009. Major funding increases will be provided to Tertiary Institutions (K6.5 million), National Broadcasting Commission (K6.5 million), Office of Auditor General (K3.0 million), Ombudsman Commission (K2.9 million) and the PNG Sport Foundation (K0.4 million) for participation in the Arafura Games in 2009.

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

2.4.2.5 Interest and Other Fees

Total interest and other fees payments are projected to be K392.8 million in 2009, an increase of K34.6 million, or 9.7 per cent, from the revised estimate for 2008. The total payment is comprised of K304.0 million in domestic interest and fees outlays and K88.8 million in external interest and fees outlays.

Table 31: Interest and Other Fees 2007 – 2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Domestic Interest Outlays	252.1	275.3	304.0	28.7
Treasury Bills	*51.2*	*64.6*	*73.7*	9.1
*Inscribed Stock**	*202.2*	*206.8*	*223.5*	16.7
Other Domestic Debts	*-1.3*	*0.9*	*0.6*	-0.3
Agency Fees	*0.0*	*3.0*	*6.3*	3.3
External Interest Outlays	117.9	82.9	88.8	5.9
Interest	*117.9*	*82.1*	*70.6*	-11.5
Other Fees	*0*	*0.8*	*18.2*	17.4
Total Interest & Other Fees	**370.1**	**358.2**	**392.8**	**27.2**

Source: Department of Treasury
* Premiums on Inscribed Stock are treated as a negative interest outlay.

Domestic interest and fees are forecast to rise by K22.0 million (or 7.8 per cent) in 2009 to K304.0 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 in order to reduce exchange rate risk.

External interest payments and other fees are projected to be K88.8 million in 2009, K5.9 million, or 7.1 per cent lower than the revised estimate for 2008, reflecting a moderate rise in the value of the Kina against major debt currencies. The large increase in Other Fees is due to a subscription fee to the IMF and World Bank as well as large fees for new loans from Finland and China.

2.4.3 Development Expenditure

The 2009 Budget provides for substantially increased funding to the Development Budget to pursue its development priorities. In doing so, the Government is seeking to promote sustained economic growth through empowering and transforming the rural economy and by providing employment opportunities for our citizens.

The Development Budget for 2009 is K2,595.2 million, which is K720.5 million or 38.4 per cent higher than the revised estimate for 2008. This reflects the Government's funding allocation in 2009 increasing by K857.5 million to K1,620.9 million for 2009, partially offset by a decline in funding from the Donor agencies due to the appreciation of the Kina, and a downward revision to the Infrastructure Tax Credits.

Table 32: Development Expenditure: By Source 2007–2009 (Kina Millions)

	2007 Actual	2008 Estimate	2009 Projection	Change
Government	607.5	763.4	1620.9	857.5
Domestic Funding	*483.2*	*526.7*	*1385.9*	*859.2*
Infrastructure Tax Credit	*20.6*	*73.7*	*40.0*	*-33.7*
Loans	*102.8*	*163.0*	*195.0*	*32.0*
Concessional	101.8	163.0	195.0	32.0
Commercial	1.0	0.0	0.0	0.0
Donor	721.0	1111.2	974.3	-136.9
Project Grants	*721.0*	*1111.2*	*974.3*	*-136.9*
Total Development Expenditure	**1327.6**	**1874.6**	**2595.2**	**720.6**

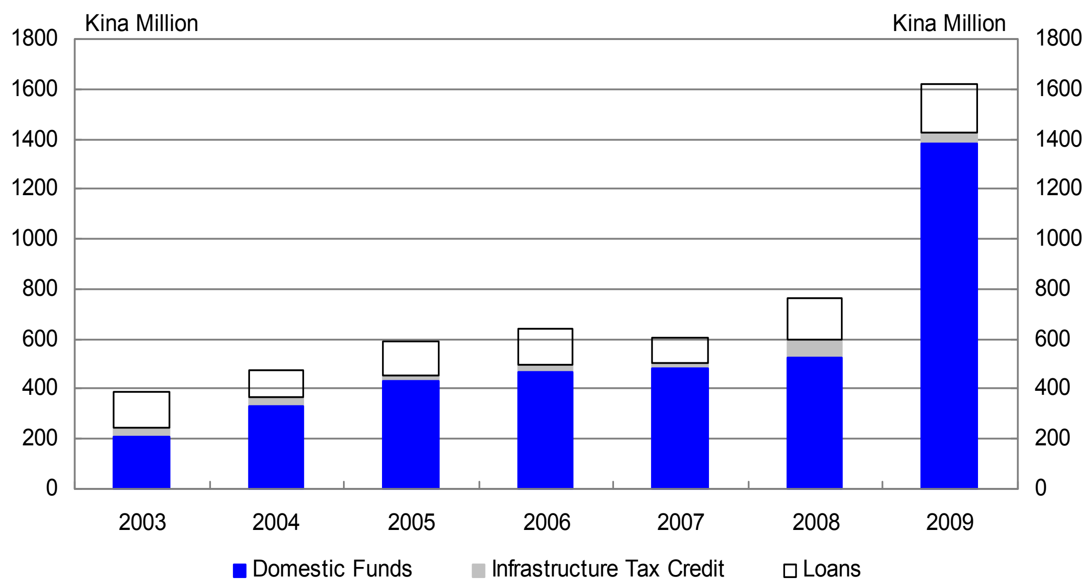
Source: Department of Treasury

The K1,385.9 million domestic funding for Development includes a series of reallocations from the Recurrent Budget and new spending measures:

• District Services Improvement Program	K356.0 million
• Transfer of National Agriculture Development Plan funds	K100.0 million
• MOA Commitments	K70.0 million
• Wharves and Bridges Funding	K60.0 million
• Additional Provincial and Rural Roads funding	K66.0 million
• Waigani Office redevelopment	K50.0 million
• National investments	K43.0 million
• Rabaul assistance package	K25.0 million
• ADB Highlands Region Road Improvement Investments Program	K38.0 million
• Prime Minister's Community College	K30.0 million
• Provincial Impact Projects	K20.0 million
• National Stadium	K20.0 million

The additional spending over and above the budget will be closely monitored and measured in order to ensure that tangible benefits are achieved in line with the Government's objectives. Details of the 2009 Development Budget can be found in Chapters 6 and 7 of this Volume.

Figure 12: Government Contribution to Development Budget (Kina Millions)



Source: Department of Treasury

2.5 FINANCING

The 2009 Budget is expected to be a small deficit of K10.3 million, effectively a balance budget when measured against GDP. This reflects the impact of reduced revenues arising from the substantial fall in commodity prices and increased expenditure announced in the 2009 Budget.

Total new external borrowing of K195.0 million is expected to be undertaken in 2009, reflecting additional drawdowns on concessional loans.

External repayments (amortization) of existing loans of K224.6 million will more than offset new borrowing, resulting in a net external outflow of K60.6 million in 2009.

The net domestic funding required in 2009 to fund the outflows in external financing will be K70.9 million. This consists of K1,496.8 million in new borrowing and amortization of K1,425.9 million. No receipts from asset sales have been factored into financing of the 2009 Budget.

CHAPTER 3. STATUS OF TRUST ACCOUNTS

3.1 OVERVIEW

This chapter provides a summary of the additional expenditure appropriated through the Additional Priority Expenditure (APE) and the Supplementary Budgets as at 30 September 2008. These expenditures are funded from the additional revenue from the commodity boom, as outlined in the 2008-2012 Medium Term Fiscal Strategy. The additional expenditures are one-off and will not add to the base of ongoing expenditure.

A majority of additional expenditures have been paid into trust accounts to pre-fund future public investments. The remaining amounts of additional expenditures were spent directly through the Budget. The purpose of holding funds in trust accounts is to:

- spread expenditure over a number of years in order to minimize the inflationary impact on the economy and to assist to avoid the boom and bust of previous commodity cycles;
- provide agencies with time to develop implementation strategies for the projects; and
- provide better value for money, as spreading expenditure through time allows companies bidding for contracts to increase their capacity in anticipation of continued public investment.

Since 2005, there have been seven different additional appropriations made over and above the ongoing annual budget which total K6,373.5 million. Of this, K1,702.2 million has been spent through the budget, K2,482.1 million has been paid into Trust Accounts, K2,188.7 million is to be released later in 2008, and K0.5 million lapsed in 2006. Further information is provided at Table 32 and Figure 13.

A description of the table headings in this chapter are as follows:

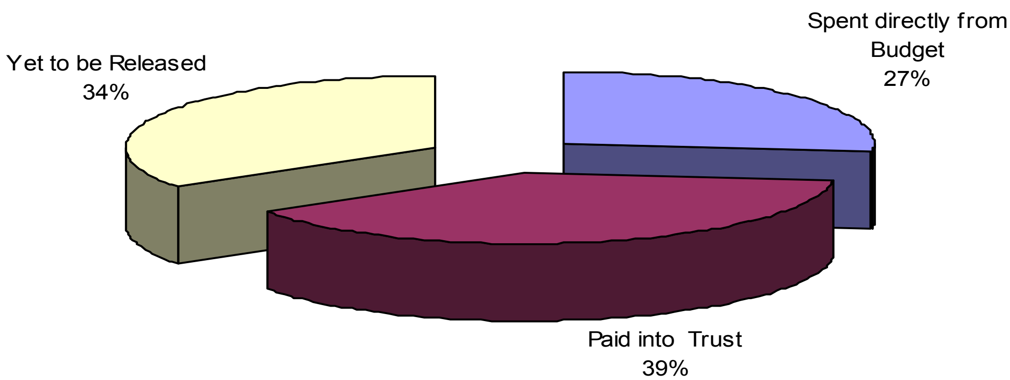
- Appropriated – the total Appropriation for each sector from the various APEs and Supplementary Budgets.
- Share of Total Appropriated – the share appropriated for each sector compared to the total appropriation.
- Spent – the amount spent directly through the Budget from the various APEs and Supplementary Budgets.
- Paid into Trust – the amount paid into Trust Accounts from the various APEs and Supplementary Budgets. This differs from the current balance in the Trust Accounts, which is discussed later in this chapter.
- Yet to be Released – the amount to be released for direct expenditure and payment into Trust Accounts when funds become available later in 2008.

Table 32: Additional Priority Expenditure and Supplementary Budget Appropriation 2005-2008

	Approp.	Spent through the Budget	Paid into Trust	Lapsed	Yet to be Released
2005 Supplementary Budget (November 2005)	400.0	0.0	400.0	0.0	0.0
2006 Supplementary Budget (August 2006)	682.5	489.9	192.1	0.5	0.0
2006 Additional Priority Expenditure (November 2006)	650.0	273.7	376.3	0.0	0.0
2007 Supplementary Budget (October 2007)	1637.0	704.0	933.0	0.0	0.0
2008 Budget - Additional Priority Expenditure (November 2007)	1704.0 1/	134.6	230.7	0.0	1338.7
2008 Supplementary Budget (September 2008)	850.0 2/	0.0	0.0	0.0	850.0
Grand Total	**6373.5**	**1702.2**	**2482.1**	**0.5**	**2188.7**

Source: Department of Finance
1/ This figure includes K200 million debt repayment/safety margin
2/ This figure includes K50 million debt repayment
These two amounts will not be transferred into trust accounts because they are treated as below the line items according to the Government Finance Statistics.

Figure 13: Breakdown of Total Appropriations as at 30th September 2008



Source: Department of Finance

The yet to be released amount of K2,188.7 million relates to the 2008 APE and Supplementary Budget. Of this, K964.0 will be spent through the budget and K1,224.7 million will be paid into Trust Accounts. This brings the total appropriation into Trust Accounts, inclusive of the amount to be paid later in 2008, to K3,706.8 million.

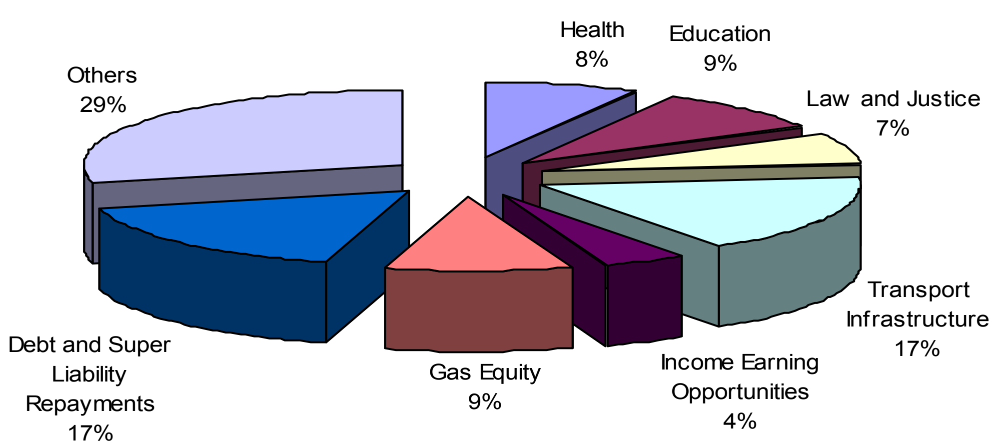
The vast majority of the funds under the APE and Supplementary Budgets have been allocated for investment purposes reflecting the Medium Term Development Strategy (MTDS) priorities. Table 35 shows the status of funds allocated to each MTDS sector.

Table 33: Supplementary Budget Appropriation and Additional Priority Expenditure by sector as at 30th September 2008 (Kina Millions)

	Appropriated	Share of Total Appropriated	Spent directly from Budget	Paid into Trust	Lapsed	Yet to be Released
	K'm	Per cent	K'm	K'm		K'm
Health	490.9	7.7	33.6	354.3		103.0
Education	596.6	9.4	39.8	416.1		140.7
Law and Justice	424.9	6.7	44.3	289.0		91.6
Transport Infrastructure	1080.1	16.9	273.1	417.0		390.0
Income Earning Opportunities	257.0	4.0	25.0	123.0		109.0
Gas Equity	600.0	9.4	0.0	500.0		100.0
Debt and Super Liability Repayments	1087.0	17.1	647.0	0.0		440.0
Others	1836.9	28.8	639.4	382.7	0.5	814.3
Total	**6373.5**	**100.0**	**1702.2**	**2482.1**	**0.5**	**2188.7**

Source: Department of Treasury and Department of Finance

Figure 14: Sectoral allocations of Supplementary Budgets and Additional Priority Expenditure Appropriations as at 30th September 2008



Source: Department of Treasury/Department of Finance

2008 Additional Priority Expenditure and Supplementary Budget

A total of K1,704.0 was appropriated for APE in the 2008 Budget. As at 30 September 2008, K230.7 million had been paid into Trust Accounts and K134.6 million had been spent

directly through the budget. The remaining balance of K1,338.7 million will be released over the remainder of 2008.

The 2008 Supplementary Budget allocated K850.0 million for additional expenditure. As at 30 September 2008, these appropriations were yet to be released. It is anticipated that the funds will be spent directly or transferred into Trust Accounts before the end of 2008.

3.2 HEALTH SECTOR

Of the K490.9 million appropriated to the Health Sector under the APE and Supplementary Budgets, K354.3 million has been paid into Trust Accounts, K28.6 million has been spent through the Budget as intended, K5.0 million has been reallocated for other expenditure, and K103.0 million is yet to be released. Details of additional expenditure for the Health Sector are shown in Table 34 below.

Table 34: Health Sector Supplementary Budget and APE Status

	Approp.	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)						
MTDS Priorities	**95.9**	**8.9**	**2.0**	**85.0**	**0.0**	**0.0**
Hospital Rehabilitation Plan	70.0	0.0	0.0	70.0	0.0	0.0
Nurse Housing	15.0	0.0	0.0	15.0	0.0	0.0
District Health Improvement	8.9	8.9	0.0	0.0	0.0	0.0
Bird Flu Preparation	2.0	0.0	2.0	0.0	0.0	0.0
Total	**95.9**	**8.9**	**2.0**	**85.0**	**0.0**	**0.0**
Health Sector	110.0	9.7	0.0	100.3	0.0	0.0
Church health workers	9.7	9.7	0.0	0.0	0.0	0.0
Other health	100.3	0.0	0.0	100.3	0.0	0.0
Total	**110.0**	**9.7**	**0.0**	**100.3**	**0.0**	**0.0**
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)						
Additions to Spending	**13.0**	**10.0**	**3.0**	**0.0**	**0.0**	**0.0**
Doctor's Back-Pay	10.0	10.0	0.0	0.0	0.0	0.0
Avian Flu - NAQIA Funding	3.0	0.0	3.0	0.0	0.0	0.0
District Infrastructure Funding	**89.0**	**0.0**	**0.0**	**89.0**	**0.0**	**0.0**
District Health Improvement Program	89.0	0.0	0.0	89.0	0.0	0.0
Public Infrastructure Maintenance Funds	**80.0**	**0.0**	**0.0**	**80.0**	**0.0**	**0.0**
Health	80.0	0.0	0.0	80.0	0.0	0.0
Total	**182.0**	**10.0**	**3.0**	**169.0**	**0.0**	**0.0**
2008 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2007)						
District Services Improvement Program	**89.0**	**0.0**	**0.0**	**0.0**	**0.0**	**89.0**
2008 SUPPLEMENTARY BUDGET (SEPTEMBER 2008)						
Church Run Hospital Partnerships	14.0					14.0

	Approp.	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
Grand Total	**490.9**	**28.6**	**5.0**	**354.3**	**0.0**	**103.0**

Source: Department of Treasury and Department of Finance

3.3 EDUCATION

Of the K596.6 million appropriated to the Education Sector under the APE and Supplementary Budgets, K416.1 million has been paid into Trust Accounts, K36.8 million has been spent through the Budget as intended, K3.0 million has been reallocated for other expenditure, and K140.7 million is yet to be released. Details of the additional expenditure for the Education Sector are shown in Table 37 below.

Table 35: Education Sector Supplementary Budget and APE Status

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)						
MTDS Priorities	**8.9**	**8.9**	**0.0**	**0.0**	**0.0**	**0.0**
District Education Improvement	*8.9*	*8.9*	*0.0*	*0.0*	*0.0*	*0.0*
Meeting Obligations	**40.0**	**14.9**	**0.0**	**25.1**	**0.0**	**0.0**
PBSS (teachers)	*40.0*	*14.9*	*0.0*	*25.1*	*0.0*	*0.0*
Non-MTDS Priorities	**12.0**	**10.0**	**0.0**	**2.0**	**0.0**	**0.0**
Emergency School Maintenance	*7.0*	*7.0*	*0.0*	*0.0*	*0.0*	*0.0*
Bana High School	*3.0*	*3.0*	*0.0*	*0.0*	*0.0*	*0.0*
Kubalia High School	*2.0*	*0.0*	*0.0*	*2.0*	*0.0*	*0.0*
Total	**60.9**	**33.8**	**0.0**	**27.1**	**0.0**	**0.0**
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
PBSS payments (teachers)	*20.0*	*0.0*	*0.0*	*20.0*	*0.0*	*0.0*
Total	**20.0**	**0.0**	**0.0**	**20.0**	**0.0**	**0.0**
2007 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
Education Infrastructure	200.0	0.0	0.0	200.0	0.0	0.0
Higher education	*50.0*	*0.0*	*0.0*	*50.0*	*0.0*	*0.0*
Other education	*150.0*	*0.0*	*0.0*	*150.0*	*0.0*	*0.0*
Total	**200.0**	**0.0**	**0.0**	**200.0**	**0.0**	**0.0**
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)						
Additions to Spending	**3.0**	**3.0**	**0.0**	**0.0**	**0.0**	**0.0**
Marienberg Community College	3.0	3.0	0.0	0.0	0.0	0.0
District Infrastructure Funding	**89.0**	**0.0**	**0.0**	**89.0**	**0.0**	**0.0**
District Education Improvement Program	89.0	0.0	0.0	89.0	0.0	0.0
Public Infrastructure Maintenance Funds	**80.0**	**0.0**	**0.0**	**80.0**	**0.0**	**0.0**
Education	*80.0*	*0.0*	*0.0*	*80.0*	*0.0*	*0.0*
Total	**172.0**	**3.0**	**0.0**	**169.0**	**0.0**	**0.0**

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2008 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2007)						
District Services Improvement Program	89.0	0.0	0.0	0.0	0.0	89.0
Tertiary Institutions Infrastructure	30.0	0.0	0.0	0.0	0.0	30.0
Technical Schools Maintenance	20.0	0.0	0.0	0.0	0.0	20.0
Lutheran University	3.0	0.0	3.0	0.0	0.0	0.0
Total	**142.0**	**0.0**	**3.0**	**0.0**	**0.0**	**139.0**
2008 SUPPLEMENTARY BUDGET (SEPTEMBER 2008)						
Land acquisitions for state schools	1.7					1.7
Grand Total	**596.6**	**36.8**	**3.0**	**416.1**	**0.0**	**140.7**

Source: Department of Treasury and Department of Finance

3.4 LAW AND JUSTICE SECTOR

Of the K424.9 million appropriated to the Law and Justice Sector under the APE and Supplementary Budgets, K289.0 million has been paid into Trust Accounts, K44.3 million has been spent through the Budget, and K91.6 million is yet to be released. Details of the additional expenditure for the Law and Justice Sector are shown in Table 36 below.

Table 36: Law & Justice Sector Supplementary Budget and APE Status

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)						
MTDS Priorities	**58.5**	**33.5**	**0.0**	**25.0**	**0.0**	**0.0**
Police Housing	25.0	0.0	0.0	25.0	0.0	0.0
Judiciary - Court House Upgrade	9.0	9.0	0.0	0.0	0.0	0.0
Police Pay	8.0	8.0	0.0	0.0	0.0	0.0
Southern Highlands Security Situation	8.0	8.0	0.0	0.0	0.0	0.0
Improved conditions for State lawyers	3.0	3.0	0.0	0.0	0.0	0.0
Land mediation for resource projects	2.5	2.5	0.0	0.0	0.0	0.0
Juvenile Detention Facilities	2.0	2.0	0.0	0.0	0.0	0.0
Border Facilities Upgrade	1.0	1.0	0.0	0.0	0.0	0.0
Meeting Obligations	**20.0**	**0.0**	**0.0**	**20.0**	**0.0**	**0.0**
PBSS (police)	20.0	0.0	0.0	20.0	0.0	0.0
Non-MTDS	**2.8**	**2.8**	**0.0**	**0.0**	**0.0**	**0.0**
Leadership Tribunals	2.8	2.8	0.0	0.0	0.0	0.0
Total	**81.3**	**36.3**	**0.0**	**45.0**	**0.0**	**0.0**
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
Law and Justice Sector	25.0	0.0	0.0	25.0	0.0	0.0
Police Housing	*25.0*	*0.0*	*0.0*	*25.0*	*0.0*	*0.0*

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
Total	**25.0**	**0.0**	**0.0**	**25.0**	**0.0**	**0.0**
2007 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
Law and Justice infrastructure	50.0	0.0	0.0	50.0	0.0	0.0
Total	**50.0**	**0.0**	**0.0**	**50.0**	**0.0**	**0.0**
2007 SECOND SUPPLEMENTARY BUDGET (OCTOBER 2007)						
Additions to Spending	**8.00**	**8.0**	**0.0**	**0.0**	**0.0**	**0.00**
Outstanding Legal Fees	*8.0*	*8.0*	*0.0*	*0.0*	*0.0*	*0.0*
District Infrastructure Funding	**89.0**	**0.0**	**0.0**	**89.0**	**0.0**	**0.0**
District Law and Justice Program	*89.0*	*0.0*	*0.0*	*89.0*	*0.0*	*0.0*
Public Infrastructure Maintenance Funds	**80.0**	**0.0**	**0.0**	**80.0**	**0.0**	**0.0**
Law and Justice	*80.0*	*0.0*	*0.0*	*80.0*	*0.0*	*0.0*
Total	**177.0**	**8.0**	**0.0**	**169.0**	**0.0**	**0.0**
2008 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2007)						
District Services Improvement Program	**89.0**	**0.0**	**0.0**	**0.0**	**0.0**	**89.0**
2008 SUPPLEMENTARY BUDGET (SEPTEMBER 2008)						
Attorney General's - Housing Allowance	2.6					2.6
Grand Total	**424.9**	**44.3**	**0.0**	**289.0**	**0.0**	**91.6**

Source: Department of Treasury and Department of Finance

3.5 TRANSPORT SECTOR

Of the K1,080.1 million appropriated to the Transport Sector under the APE and Supplementary Budgets, K417.0 million has been paid into Trust Accounts, K273.1 million has been spent through the Budget, and K390.0 million is yet to be released. Details of the additional expenditure for the Transport Sector are shown in Table 37 below.

Table 37: Transport Sector Supplementary Budget & APE Status

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)						
MTDS Priorities	**235.5**	**215.5**	**0.0**	**20.0**	**0.0**	**0.0**
Highlands Highway	70.0	70.0	0.0	0.0	0.0	0.0
District Transport Inf. Project	44.5	44.5	0.0	0.0	0.0	0.0
Airport Rehabilitation	30.0	10.0	0.0	20.0	0.0	0.0
Gurney Airport	2.0	2.0	0.0	0.0	0.0	0.0
Road & Bridge Maintenance	22.0	22.0	0.0	0.0	0.0	0.0
Commodity Roads Improvement	20.0	20.0	0.0	0.0	0.0	0.0
ADB Navigational Aids	7.4	7.4	0.0	0.0	0.0	0.0

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
Gazelle Restoration	9.6	9.6	0.0	0.0	0.0	0.0
Gobe-Semberigi	10.0	10.0	0.0	0.0	0.0	0.0
Buka Ring Road	10.0	10.0	0.0	0.0	0.0	0.0
Napa Napa Road Link	5.0	5.0	0.0	0.0	0.0	0.0
District Vessels	5.0	5.0	0.0	0.0	0.0	0.0
Total	**235.5**	**215.5**	**0.0**	**20.0**	**0.0**	**0.0**
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
Transport Sector	76.0	0.0	0.0	76.0	0.0	0.0
Highlands Highway	35.0	0.0	0.0	35.0	0.0	0.0
National Roads	21.0	0.0	0.0	21.0	0.0	0.0
Provincial Roads	20.0	0.0	0.0	20.0	0.0	0.0
Total	**76.0**	**0.0**	**0.0**	**76.0**	**0.0**	**0.0**
2007 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
Transport Sector Infrastructure	44.0	0.0	0.0	44.0	0.0	0.0
District Roads	20.0	0.0	0.0	20.0	0.0	0.0
Ports and jetties	14.0	0.0	0.0	14.0	0.0	0.0
Wewak airport	10.0	0.0	0.0	10.0	0.0	0.0
Total	**44.0**	**0.0**	**0.0**	**44.0**	**0.0**	**0.0**
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)						
Approved Programs	**21.00**	**21.0**	**0.0**	**0.0**	**0.0**	**0.00**
CAA	21.0	21.0	0.0	0.0	0.0	0.0
Major Improvements in Infrastructure	**257.0**	**0.0**	**0.0**	**257.0**	**0.0**	**0.0**
Lae Roads	25.0	0.0	0.0	25.0	0.0	0.0
Lae Port	145.0	0.0	0.0	145.0	0.0	0.0
Wewak Wharf	37.0	0.0	0.0	37.0	0.0	0.0
Central City	30.0	0.0	0.0	30.0	0.0	0.0
Wewak Town Roads	10.0	0.0	0.0	10.0	0.0	0.0
Port Moresby Wharf	10.0	0.0	0.0	10.0	0.0	0.0
Total	**278.0**	**21.0**	**0.0**	**257.0**	**0.0**	**0.0**
2008 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2007)						
District Services Improvement Programs	89.0	0.0	0.0	0.0	0.0	89.0
National Road Maintenance	50.0	31.0	0.0	0.0	0.0	19.0
Lae Roads	25.0	0.0	0.0	0.0	0.0	25.0
Central City	20.0	0.0	0.0	20.0	0.0	0.0
South Bougainville Feeder Roads	4.1	4.1	0.0	0.0	0.0	0.0
Buka/Arawa Road - pre-funding	3.0	1.5	0.0	0.0	0.0	1.5
Total	**191.1**	**36.6**	**0.0**	**20.0**	**0.0**	**134.5**

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2008 SUPPLEMENTARY BUDGET (SEPTEMBER 2008)						
Priority Roads	90.0					90.0
Rural Town Roads	64.0					64.0
Lae Ports	21.5					21.5
Ports, Wharves & Jetties	20.0					20.0
Airport Upgrades	20.0					20.0
National/Rural Bridges	35.0					35.0
Road Feasibility Studies	5.0					5.0
Total	**255.5**	**0.0**	**0.0**	**0.0**	**0.0**	**255.5**
Grand Total	**1,080.1**	**273.1**	**0.0**	**417.0**	**0.0**	**390.0**

Source: Department of Treasury and Department of Finance

3.6 INCOME EARNING OPPORTUNITY SECTOR

Of the K257.0 million appropriated to the Income Earning Opportunity Sector under the APE and Supplementary Budgets, K123.0 million has been paid into Trust Accounts, K24.0 million has been spent through the Budget as indicated, K1.0 million has been reallocated to other expenditure, and K109.0 million is yet to be released. Details of the additional expenditure for the Income Earning Sector are shown in Table 38 below.

Table 38: Income Earning Opportunity Sector Supplementary Budget and APE Status

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Release d
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)						
MTDS Priorities	**25.0**	**10.0**	**0.0**	**15.0**	**0.0**	**0.0**
Gas Project Business Development	15.0	0.0	0.0	15.0	0.0	0.0
Cocoa Pod Outbreak	10.0	10.0	0.0	0.0	0.0	0.0
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
Agriculture Projects	35.0	0.0	0.0	35.0	0.0	0.0
Total	**35.0**	**0.0**	**0.0**	**35.0**	**0.0**	**0.0**
2007 ADDITIONAL PRIORITY EXPENDITURE (November 2006)						
District markets	20.0	0.0	0.0	20.0	0.0	0.0
Agriculture Projects	5.0	0.0	0.0	5.0	0.0	0.0
Total	**25.0**	**0.0**	**0.0**	**25.0**	**0.0**	**0.0**
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)						
Approved Programs	**40.0**	**0.0**	**0.0**	**40.0**	**0.0**	**0.0**
NADP	40.0	0.0	0.0	40.0	0.0	0.0
Additions to Spending	**15.0**	**14.0**	**1.0**	**0.0**	**0.0**	**0.0**
Cocoa Pod Borer	12.0	11.0	1.0	0.0	0.0	0.0
National Forest Authority - Impact Projects	3.0	3.0	0.0	0.0	0.0	0.0
Total	**55.0**	**14.0**	**1.0**	**40.0**	**0.0**	**0.0**

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Release d
2008 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2007)						
District Services Improvement Program	89.0	0.0	0.0	0.0	0.0	89.0
NADP	28.0	0.0	0.0	8.0	0.0	20.0
Total	**117.0**	**0.0**	**0.0**	**8.0**	**0.0**	**109.0**
Grand Total	**257.0**	**24.0**	**1.0**	**123.0**	**0.0**	**109.0**

Source: Department of Treasury and Department of Finance

3.7 GAS EQUITY

The total appropriation to Gas Equity from the APE and Supplementary Budgets is K600.0 million. Of this, K500.0 million has been transferred into trust accounts and K100.0 million is yet to be transferred.
If Government revenue is sufficiently stronger than forecast in 2009 to enable the funding of K423 million of additional spending in 2009, the funds in this trust will be retained. However, if revenue is in line with forecasts or weaker, the balance of this Trust Account will be returned to Consolidated Revenue in 2009. Of this, K177 million will be transferred to a new trust to meet Government costs associated with the commercialization of the gas reserves. The remaining K423 million will be used to fund additional spending in the recurrent and development budgets in 2009.

Table 39: Gas Equity Funding

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2005 SUPPLEMENTARY BUDGET (NOVEMBER 2005)						
Gas Pipeline Equity	400.0	0.0	0.0	400.0	0.0	0.0
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
Gas Project Equity	100.0	0.0	0.0	100.0	0.0	0.0
2008 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2007)						
State Equity in Gas Project/s	100.0	0.0	0.0	0.0	0.0	100.0
Grand Total	**600.0**	**0.0**	**0.0**	**500.0**	**0.0**	**100.0**

Source: Department of Treasury and Department of Finance

3.8 DEBT REPAYMENT

A total of K1,087.0 million has been appropriated for Debt and Superannuation Liability Repayments under the APE and Supplementary Budgets. Of this, K397.0 million has been used to repay debt, K250 million has been used to repay superannuation liabilities, and K440.0 million is yet to be paid.

Table 40: Debt Repayment Status

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2006 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2006)						
Debt repayment	100.0	100.0	0.0	0.0	0.0	0.0
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)						
Nambawan Superannauation - Liability Reduction	250.0	250.0	0.0	0.0	0.0	0.0
Debt repayment	297.0	297.0	0.0	0.0	0.0	0.0
2008 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2007)						
Nambawan Superannuation - Liability Reduction	150.0	0.0	0.0	0.0	0.0	150.0
Debt Repayment / Safety Margin	200.0	0.0	0.0	0.0	0.0	200.0
2008 SUPPLEMENTARY BUDGET (SEPTEMBER 2008)						
Publc Debt Repayment	50.0					50.0
Nambawan Super - Liability Reduction	40.0					40.0
Grand Total	**1,087.0**	**647.0**	**0.0**	**0.0**	**0.0**	**440.0**

Source: Department of Treasury and Department of Finance

3.9 OTHER EXPENDITURE

A total of K1,836.9 million has been appropriated for various one-off expenditure obligations, economic impact recurrent expenditure, maintenance, and other expenditure that supports the MTDS Priorities. Details of these transactions are shown in Table 41.

Table 41: Other expenditure

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
2006 SUPPLEMENTARY BUDGET (AUGUST 2006)						
MTDS Priorities	**22.0**	**22.0**	**0.0**	**0.0**	**0.0**	**0.0**
Economic Projects Power Upgrade	8.0	8.0	0.0	0.0	0.0	0.0
Provincial Economic Impact	7.0	7.0	0.0	0.0	0.0	0.0
Rural Electrification	4.0	4.0	0.0	0.0	0.0	0.0
Economic Projects Water Upgrade	3.0	3.0	0.0	0.0	0.0	0.0
Meeting Obligations	**112.8**	**112.8**	**0.0**	**0.0**	**0.0**	**0.0**
Outstanding MOA projects	36.0	36.0	0.0	0.0	0.0	0.0
Sec Advance	20.0	20.0	0.0	0.0	0.0	0.0
Additional SSGs	19.0	19.0	0.0	0.0	0.0	0.0
Outstanding DDP	13.9	13.9	0.0	0.0	0.0	0.0
Outstanding BRF	10.0	10.0	0.0	0.0	0.0	0.0

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
Outstanding Court Orders	5.0	5.0	0.0	0.0	0.0	0.0
O/S SDDG	4.9	4.9	0.0	0.0	0.0	0.0
O/S DSG	4.0	4.0	0.0	0.0	0.0	0.0
Non-MTDS	**49.1**	**48.6**	**0.0**	**0.0**	**0.5**	**0.0**
District Treasury Rollout	22.0	22.0	0.0	0.0	0.0	0.0
Politicians Allowances	6.0	6.0	0.0	0.0	0.0	0.0
Manam Resettlement Requirements	4.0	4.0	0.0	0.0	0.0	0.0
Members Retirement Benefits	3.7	3.7	0.0	0.0	0.0	0.0
CoI into Finance	3.7	3.7	0.0	0.0	0.0	0.0
Pacific Balanced Fund investigation	2.5	2.0	0.0	0.0	0.5	0.0
National Urbanisation Policy	2.5	2.5	0.0	0.0	0.0	0.0
Intra Govt Info system	1.5	1.5	0.0	0.0	0.0	0.0
Disabled Rehab Support	1.1	1.1	0.0	0.0	0.0	0.0
Events Council Overrun	0.7	0.7	0.0	0.0	0.0	0.0
Moruata House - Lift Modernisation	0.6	0.6	0.0	0.0	0.0	0.0
Moitaka Wildlife Feasibility Study	0.5	0.5	0.0	0.0	0.0	0.0
PAC Additional Funding	0.3	0.3	0.0	0.0	0.0	0.0
Total	**183.9**	**183.4**	**0.0**	**0.0**	**0.5**	**0.0**
2006 SUPPLEMENTARY BUDGET (NOVEMBER 2006)						
Water scoping studies	9.0	9.0	0.0	0.0	0.0	0.0
Equity into SOEs	130.0	130.0	0.0	0.0	0.0	0.0
Public service sign on	25.0	0.0	25.0	0.0	0.0	0.0
Volcano victims	20.0	0.0	0.0	20.0	0.0	0.0
Total	**184.0**	**139.0**	**25.0**	**20.0**	**0.0**	**0.0**
2007 SUPPLEMENTARY BUDGET (NOVEMBER 2006)						
District Finance Rollout	30.0	30.0	0.0	0.0	0.0	0.0
NBC infrastructure	21.0	0.0	0.0	21.0	0.0	0.0
Bougainville infrastructure	20.0	20.0	0.0	0.0	0.0	0.0
Maintenance of Parliament	10.0	0.0	0.0	10.0	0.0	0.0
Phasing of election	30.0	0.0	30.0	0.0	0.0	0.0
Parliament one offs	20.0	20.0	0.0	0.0	0.0	0.0
Total	**131.0**	**70.0**	**30.0**	**31.0**	**0.0**	**0.0**
2007 SUPPLEMENTARY BUDGET (OCTOBER 2007)						
Approved Programs	**17.4**	**17.4**	**0.0**	**0.0**	**0.0**	**0.0**
Provincial Disaster Fund	7.0	7.0	0.0	0.0	0.0	0.0
Maritime Boundary Project	5.0	5.0	0.0	0.0	0.0	0.0
Technical Rapid Response	3.0	3.0	0.0	0.0	0.0	0.0

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
Greenhouse Office	1.0	1.0	0.0	0.0	0.0	0.0
Office of Rural Development	0.8	0.8	0.0	0.0	0.0	0.0
Community Development	0.6	0.6	0.0	0.0	0.0	0.0
Additions to Spending	**79.6**	**75.1**	**4.6**	**0.0**	**0.0**	**0.0**
2007 National Election - cost overruns	15.0	15.0	0.0	0.0	0.0	0.0
Secretary's Advance	20.0	19.2	0.8	0.0	0.0	0.0
SSGs	15.0	11.2	3.8	0.0	0.0	0.0
Defence Force - New Uniforms	8.0	8.0	0.0	0.0	0.0	0.0
Court Orders	8.5	8.5	0.0	0.0	0.0	0.0
Murik Lakes Resettlement Project	2.1	2.1	0.0	0.0	0.0	0.0
Carteret Island Resettlement	2.0	2.0	0.0	0.0	0.0	0.0
Mirigini and Morata Haus Refurbishment	4.0	4.0	0.0	0.0	0.0	0.0
FMIP Funding Gap	2.0	2.0	0.0	0.0	0.0	0.0
Land Development Committee	3.0	3.0	0.0	0.0	0.0	0.0
District Infrastructure Funding	**89.0**	**0.0**	**0.0**	**89.0**	**0.0**	**0.0**
District Water Supply Program	89.0	0.0	0.0	89.0	0.0	0.0
Major Improvements in Infrastructure	**40.0**	**0.0**	**0.0**	**40.0**	**0.0**	**0.0**
Institutional Housing - pilot projects	10.0	0.0	0.0	10.0	0.0	0.0
Urbanisation - pilot projects	15.0	0.0	0.0	15.0	0.0	0.0
Housing Development - pilot projects	15.0	0.0	0.0	15.0	0.0	0.0
Total	**226.0**	**92.4**	**4.6**	**129.0**	**0.0**	**0.0**
2008 ADDITIONAL PRIORITY EXPENDITURE (NOVEMBER 2007)						
Additional Investment Expenditure	**334.9**	**0.0**	**0.0**	**100.0**	**0.0**	**234.9**
District Services Improvement Programs	89.0	0.0	0.0	0.0	0.0	89.0
National Infrastructure Development Program	195.9	0	0	100	0	95.9
Konebada Petroleum Park Infrastructure	50.0	0.0	0.0	0.0	0.0	50.0
Additional Priority Expenditure	**291.0**	**95.0**	**0.0**	**102.7**	**0.0**	**93.3**
Outstanding MOAs	55.0	55.0	0.0	0.0	0.0	0.0
Government Aircraft	40.0	0.0	0.0	0.0	0.0	40.0
Rural Electrification	30.0	0.0	0.0	22.7	0.0	7.3
Land Reform Program	28.0	0.0	0.0	28.0	0.0	0.0
Public Servant Housing	27.0	0.0	0.0	27.0	0.0	0.0
Maritime Boundaries	25.0	25.0	0.0	0.0	0.0	0.0
ICT Policy	20.0	5.0	0.0	0.0	0.0	15.0

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
Misima Mine Closure	20.0	0.0	0.0	0.0	0.0	20.0
Border Development	20.0	10.0	0.0	0.0	0.0	10.0
Madang Marine Park	15.0	0.0	0.0	15.0	0.0	0.0
Cooperative Societies	10.0	0.0	0.0	10.0	0.0	0.0
Bougainville Regional Office	1.0	0.0	0.0	0.0	0.0	1.0
Total	**625.9**	**95.0**	**0.0**	**202.7**	**0.0**	**328.2**
2008 SUPPLEMENTARY BUDGET (SEPTEMBER 2008)						
NBC - National TV Service	12.0					12.0
Outstanding Land Settlements	12.0					12.0
Office of Climate Change	3.8					3.8
Finance - Commission of Inquiry	10.0					10.0
National Disaster Office - O/s payments for Oro	6.5					6.5
National Planning Tech Advisory Team	5.0					5.0
Bougainville Office	0.5					0.5
Regional Provincial Treasury & District Admin Offices	26.0					26.0
Defence liabilities	1.4					1.4
Museum - Airconditioner & Generator	1.4					1.4
Electoral Commission - O/s payments for 2007 Elections	12.9					12.9
IFMS	5.9					5.9
Secretary's Advance	12.6					12.6
PNG National Games	2.3					2.3
Government House - Additional Funding	1.6					1.6
National Parliament - Additional Funding	6.0					6.0
Public Accounts Committee	1.3					1.3
Mirigini House Renovation	3.0					3.0
PM's Overseas & Domestic Commitments	5.0					5.0
Court Orders	20.0					20.0
PNG Canberra Office - Purchase of Residence	12.0					12.0
Public Service Housing	10.0					10.0
Waigani Office Redevelopment	10.0					10.0
MOAs						0.0
Southern Highlands Province	100.0					100.0

	Approp	Spent as Indicated	Spent - Other	Paid Into Trust	Lapsed	Yet to be Released
Gulf Province	60.0					60.0
Gobe Samberigi Road	10.0					10.0
Hela	2.5					2.5
Jiwaka	2.5					2.5
Expenditure Implementation Committee	20.0					20.0
Air Niugini - purchase of aircraft	70.0					70.0
National Border Authority	40.0					40.0
Total	**486.2**	**0.0**	**0.0**	**0.0**	**0.0**	**486.2**
Grand Total	**1,836.9**	**579.8**	**59.6**	**382.7**	**0.5**	**814.3**

Source: Department of Treasury and Department of Finance

3.10 TRUST ACCOUNTS TRANSACTIONS

A total of K3,706.8 million, up to and including the 2008 Supplementary Budget, has been appropriated to Trust Accounts for implementation of priority expenditure projects.

The table below shows the movements of these Trust Accounts for the period 1 January to 30 September 2008.

Table 42: Trust Accounts Transaction to 30 September 2008

Description	Paid into Trust	Opening Balance as at 1-Jan-08	Debit (Receipt)	Credit (Payment)	Closing Balance as at 30-Sep-08	Deposits Outstanding as at 30-Sep-08
Gas Commercialisation Equity Financing	500.0	500.0	-	-	500.0	-
Agriculture Sector Development	88.0	30.4	40.1	26.9	43.7	8.0
Airport Repairs and Upgrades	30.0	23.7	-	22.7	1.0	-
Kubalia High School Rehabilitation	2.0	2.0	-	1.7	0.3	-
Outstanding PBSS (Teachers)	45.1	45.3	0.1	-	45.4	-
Education Sector Infrastructure Rehabilitation	230.0	150.1	80.5	0.9	229.7	-
Higher Education Sector Infrastructure Rehabilitation	50.0	44.5	0.1	26.1	18.4	-
Law & Justice Sector Infrastructure Rehabilitation	130.0	50.0	80.3	-	130.4	-
Strategic District	20.0	20.0	-	3.0	17.1	-

Description	Paid into Trust	Opening Balance as at 1-Jan-08	Debit (Receipt)	Credit (Payment)	Closing Balance as at 30-Sep-08	Deposits Outstanding as at 30-Sep-08
Markets Infrastructure						
National Parliament Infrastructure Rehabilitation	10.0	10.0	-	3.4	6.6	-
Outstanding PBSS (Police)	20.0	3.0	-	3.0	-	-
Transport Sector Infrastructure Rehabilitation	352.0	325.6	0.4	32.7	293.4	20.0
PNG Gas Development and Commitments	15.0	15.0	-	4.2	10.8	-
Resettlement of Volcano Victims	20.0	18.6	-	2.7	16.0	-
NBC Infrastructure Rehabilitation	21.0	16.7	-	9.5	7.2	-
Hospital and Healthcare Centre Rehabilitation	250.3	227.8	0.3	16.8	211.2	-
Rehabilitation of Housing for Nurses	15.0	15.0	-	-	15.1	-
Rehabilitation of Housing for Police	50.0	47.2	0.1	0.5	46.8	-
Highlands Highway Rehabilitation	35.0	35.0	-	33.1	1.9	-
District Services Improvement	356.0	-	356.0	43.9	312.1	-
Urbanization Pilots	15.0	-	15.0	-	15.0	-
Institutional Housing Pilot	37.0	-	37.0	2.3	34.7	-
Housing Development Pilot	15.0	-	15.0	-	15.0	-
Cooperative Societies Esblishment	10.0	-	5.0	-	5.0	5.0
Madang Marine Park Development	15.0	-	15.0	-	15.0	-
Rural Electrification	22.7	-	-	-	-	22.7
Konebada Petroleum Park	-	-	-	-	-	-
National Infrastructure Development	100.0	-	100.0	-	100.0	-
Land Reform Program	28.0	-	14.0	-	14.0	14.0
	2,482.1	**1,580.0**	**759.1**	**233.5**	**2,105.7**	**69.7**

Source: Department of Finance

Of the K3,706.8 million appropriated to Trust Accounts, as at 30 September 2008 K2,482.1 million had been released by the Department of Treasury into Trust Accounts (including outstanding deposits). The remaining K1,224.7 million relates to the 2008 Recurrent Budget and the 2008 Supplementary Budget and will be released by the Department of Treasury as funds become available prior to the end of 2008.

The opening balance as at 1 January 2008 of Supplementary Budget Trust Accounts was K1,580.0 million. Total Receipts for the period 1 January to 30 September equals K759.1 million and comprises Appropriations transferred from Department of Treasury for the year to date of K757.0 million and Interest earned on these Trust Fund deposits of K2.1 million. A further K69.7 million (Appropriations) has been released by Department of Treasury but is yet to be deposited into the relevant Trust Account as at 30 September 2008. Total Expenditure incurred for the period 1 January to 30 September 2008 totaled K233.5 million. The closing balance of Supplementary Budget Trust Accounts at 30 September 2008 is K2,105.7 million.

Following is a summary of expenditure from Supplementary Budget Trust Accounts for the period 1 January to 30 September 2008:

- **K26.9 million was spent from the Agriculture Sector Development Trust Account**. No financial or project reporting has been provided by the Implementing Agency, the Department of Agriculture, to the Department of Finance to support the expenditure from this Trust Account.
- **K22.7 million was spent from the Airport Repairs and Upgrade Trust Account**. No financial or project reporting has been provided by the Implementing Agency, the Civil Aviation Authority of PNG, to the Department of Finance since the inception of this Trust Account.
- **K1.7 million was spent from the Kubalia High School Rehabilitation Trust Account** for infrastructure rehabilitation at Kubalia High School.
- **K0.9 million was spent from the Education Sector Infrastructure Rehabilitation Trust Account** for infrastructure rehabilitation of District Schools. Management and responsibility for the Education Sectors Infrastructure Rehabilitation Trust Account was transferred from the Department of Education to the Department of National Planning and Monitoring on 11 August 2008.
- **K26.1 million was spent from the Higher Education Sector Infrastructure Rehabilitation Trust Account**. The break up of this expenditure across Higher Education Institutions is as follows:

  University of PNG K11.7 million

  General Maintenance K6.7 million, Generator Repairs and Upgrades K2.2 million, Air Conditioning Repairs and Upgrades K1.1 million, Equipment K0.5 million, Electrical Repairs K0.5 million, Buses K0.4 million and Other 0.3 million.

  University of Technology K10.5 million

  General Maintenance K6.6 million, Equipment – Learning K1.7 million, Equipment K0.8 million, Air Conditioning Repairs and Upgrades K0.6 million, Electrical Repairs including Generator Upgrades K0.4 million and Buses K0.4 million.

  University of Vudal K2.3 million

  General Maintenance K2.3 million.

  University of Goroka K1.6 million

General Maintenance K1.3 million, Equipment K0.2 million and a Truck K0.1 million.

- **K3.0 million was spent from the Strategic District Markets Infrastructure Trust Account** for District Market Development within Manus K0.5 million and Tari K2.5 million.
- **K3.4 million was spent from the National Parliament Infrastructure Rehabilitation Trust Account** for the purchase of a new Generator for Parliament House.
- **K3.0 million was transferred from the Outstanding PBSS (Police) Trust Account** to the Royal PNG Constabulary Communication and Infrastructure Trust Account following the settlement of all outstanding PBSS payments in 2007.
- **K32.7 million was spent from the Transport Sector Infrastructure Rehabilitation Trust Account**. The break-up of this expenditure is District Feeder Roads K16.0 million, Lae City Roads K8.1 million, Town Roads K5.0 million, Ports and Jetties K2.6 million and Provincial Roads K1.0 million.
- **K4.2 million was spent from the PNG Gas Development and Commitments Trust Account** for business development grants to incorporated companies of landowners.
- **K2.7 million was spent from the Resettlement of Volcano Victims Trust Account**. No financial or project reporting has been provided by the Implementing Agency, the East New Britain Provincial Government, to the Department of Finance since the inception of this Trust Account.
- **K9.5 million was spent from the NBC Infrastructure Rehabilitation Trust Account**. No financial or project reporting has been provided by the Implementing Agency, the National Broadcasting Commission, to the Department of Finance for the period.
- **K16.8 million was spent from the Hospital and Healthcare Centre Rehabilitation Trust Account**. The break-up of this expenditure is New Construction K5.4 million, Medical Equipment K4.0 million, General Maintenance K2.5 million, Vehicles (including Ambulances) K2.2 million, Project Management Fees K2.2 million and Other Expenditure K0.5 million. Management and responsibility for the Hospital and Healthcare Centre Rehabilitation Trust Account was transferred from the Department of Health to the Department of National Planning and Monitoring on 11 August 2008.
- **K0.5 million was spent from the Rehabilitation of Housing for Police Trust Account.** No financial or project reporting has been provided by the Implementing Agencies, the Royal Papua New Guinea Constabulary, to the Department of Finance for this period.
- **K33.1 million was spent from the Highlands Highway Rehabilitation Trust Account** on rehabilitation of the Kundiawa – Miunde Bridge and Mangiro Bridge – portions of the Highlands Highway.
- **K43.9 million was spent from the District Service Improvement Program Trust Account**. No financial or project reporting has been provided by the Implementing Agencies, the relevant Districts, to the Department of Finance for the period. Refer Table 43 for a full listing of District Service Improvement Program Accounts.
- **K2.3 million was spent from the Institutional Housing Pilot Trust Account**. The break-up of this expenditure is New Public Servant Accommodation K2.2 million and General Maintenance K0.1 million.

- There was no expenditure for the period 1 January to 30 September 2008 for the following Trust Accounts:
  - Gas Commercialisation Equity Financing Trust Account
  - Outstanding PBSS (Teachers) Trust Account
  - Law and Justice Sector Infrastructure Trust Account
  - Rehabilitation of Housing for Nurses Trust Account
  - Urbanisation Pilots Trust Account
  - Housing Development Pilot Trust Account
  - Cooperative Societies Establishment Trust Account
  - Madang Marine Park Development Trust Account
  - Rural Electrification Trust Account
  - Konebada Petroleum Park Trust Account
  - National Infrastructure Development Program Trust Account
  - Land Reform Program Trust Account

3.11 DISTRICT SERVICE IMPROVEMENT PROGRAM TRUST ACCOUNTS

A total K890.0 million was appropriated through the 2007 Additional Supplementary Budget and the 2008 Recurrent Budget for priority expenditures within the 89 Districts.

For ease of management of these funds an individual bank account has been established for each of the 89 Districts, and to date the first K4million has been transferred to each of the 89 District bank accounts.

The Department of Finance, in consultation with the Departments of Treasury and Planning and the Office of Rural Development, have developed Finance Instruction 3C/2008 which provides guidance on the use and management of these funds. To date no reporting have been provided to the Department of Finance to support the expenditure, however measures are being taken to ensure reporting in the future is improved.

The table below shows the movements of funds for the period 1 January – 30 September 2008 for each of the 89 District Service Improvement Program Bank Accounts.

Table 43: Movement of District Service Improvement Program Bank Accounts Year to Date 2008 (Kina millions)

District	Total Approp	Opening Balance as at 1-Jan-08	Debits (Receipts)	Credits (Payments)	Closing Balance as at 30-Sep-08
Central Province					
Abau District	10.0	-	4.0	1.9	2.1
Goilala District	10.0	-	4.0	2.9	1.1
Kairuku Hiri District	10.0	-	4.0	1.7	2.3
Rigo District	10.0	-	4.0	1.4	2.6
East New Britain					
Gazelle District	10.0	-	4.0	0.8	3.2
Kokopo District	10.0	-	4.0	-	4.0
Pomio District	10.0	-	4.0	-	4.0
Rabaul District	10.0	-	4.0	0.2	3.8
East Sepik					
Ambunti-Drekikir District	10.0	-	4.0	0.2	3.8
Angoram District	10.0	-	4.0	-	4.0

District	Total Approp	Opening Balance as at 1-Jan-08	Debits (Receipts)	Credits (Payments)	Closing Balance as at 30-Sep-08
Maprik District	10.0	-	4.0	0.2	3.8
Wewak District	10.0	-	4.0	0.3	3.7
Wosera-Gawi District	10.0	-	4.0	0.1	3.9
Yangogoru-Saussia District	10.0	-	4.0	3.0	1.0
Eastern Highlands					
Daulo District	10.0	-	4.0	0.1	3.9
Goroka District	10.0	-	4.0	0.8	3.2
Henganofi District	10.0	-	4.0	0.2	3.8
Kainantu District	10.0	-	4.0	0.1	3.9
Lufa District	10.0	-	4.0	-	4.0
Obura-Wanenara District	10.0	-	4.0	-	4.0
Okapa District	10.0	-	4.0	-	4.0
Unggai-Bena District	10.0	-	4.0	-	4.0
Enga					
Kandep District	10.0	-	4.0	0.1	3.9
Kompiam-Ambun District	10.0	-	4.0	-	4.0
Lagaip-Porgera District	10.0	-	4.0	0.9	3.1
Wabag District	10.0	-	4.0	0.1	3.9
Wapenamanda District	10.0	-	4.0	1.4	2.6
Gulf					
Kerema District	10.0	-	4.0	1.4	2.6
Kikori District	10.0	-	4.0	2.0	2.0
Madang					
Bogia District	10.0	-	4.0	-	4.0
Madang District	10.0	-	4.0	-	4.0
Middle Ramu District	10.0	-	4.0	-	4.0
Raikos District	10.0	-	4.0	-	4.0
Sumkar District	10.0	-	4.0	0.4	3.6
Usino-Bundi District	10.0	-	4.0	-	4.0
Manus					
Manus District	10.0	-	4.0	-	4.0
Milne Bay					
Alotau / Rabaraba District	10.0	-	4.0	-	4.0
Esa'ala District	10.0	-	4.0	0.1	3.9
Kiriwina Good Enough	10.0	-	4.0	-	4.0
Samarai Murua District	10.0	-	4.0	0.1	3.9
Morobe					
Bulolo District	10.0	-	4.0	3.4	0.6
Finschaffen District	10.0	-	4.0	1.0	3.0
Huon Gulf District	10.0	-	4.0	0.1	3.9
Kabwum District	10.0	-	4.0	-	4.0
Lae District	10.0	-	4.0	-	4.0
Markham District	10.0	-	4.0	-	4.0

District	Total Approp	Opening Balance as at 1-Jan-08	Debits (Receipts)	Credits (Payments)	Closing Balance as at 30-Sep-08
Menyamya District	10.0	-	4.0	0.1	3.9
Nawaeb District	10.0	-	4.0	1.4	2.6
Tewa-Siasi District	10.0	-	4.0	0.3	3.7
NCD					
Moresby North East District	10.0	-	4.0	-	4.0
Moresby North West District	10.0	-	4.0	-	4.0
Moresby South District	10.0	-	4.0	-	4.0
New Ireland					
Kavieng District	10.0	-	4.0	-	4.0
Namatanai District	10.0	-	4.0	-	4.0
North Solomon					
Central Bougainville District	10.0	-	4.0	-	4.0
North Bougainville District	10.0	-	4.0	-	4.0
South Bougainville District	10.0	-	4.0	-	4.0
Oro					
Ijivitari District	10.0	-	4.0	-	4.0
Sohe District	10.0	-	4.0	1.2	2.8
Sandaun					
Aitape-Lumi District	10.0	-	4.0	0.2	3.8
Nuku District	10.0	-	4.0	3.2	0.8
Telefomin District	10.0	-	4.0	-	4.0
Vanimo-Green District	10.0	-	4.0	-	4.0
Simbu					
Chuave District	10.0	-	4.0	0.3	3.7
Gumine District	10.0	-	4.0	0.6	3.4
Karamui-Nomane District	10.0	-	4.0	0.2	3.8
Kerowagi District	10.0	-	4.0	0.8	3.2
Kundiawa-Gembogl District	10.0	-	4.0	0.1	3.9
Sinasina-Yongumugl District	10.0	-	4.0	0.3	3.7
Southern Highlands					
Ialibu-Pangia District	10.0	-	4.0	-	4.0
Imbongu District	10.0	-	4.0	1.3	2.7
Kagua-Erave District	10.0	-	4.0	-	4.0
Komo-Magarima District	10.0	-	4.0	1.7	2.3
Koroba-L/Kopiago District	10.0	-	4.0	2.1	1.9
Mendi District	10.0	-	4.0	-	4.0
Nipa-Kutubu District	10.0	-	4.0	-	4.0
Tari-Pori District	10.0	-	4.0	0.8	3.2
West New Britain					
Kandrian District	10.0	-	4.0	-	4.0
Talasea District	10.0	-	4.0	-	4.0
Western					
Middle Fly District	10.0	-	4.0	-	4.0

District	Total Approp	Opening Balance as at 1-Jan-08	Debits (Receipts)	Credits (Payments)	Closing Balance as at 30-Sep-08
North Fly District	10.0	-	4.0	-	4.0
South Fly District	10.0	-	4.0	-	4.0
Western Highlands					
Dei District	10.0	-	4.0	-	4.0
Hagen District	10.0	-	4.0	0.1	3.9
Jimi District	10.0	-	4.0	2.9	1.1
Mul/Bayer District	10.0	-	4.0	0.7	3.3
North Wahgi	10.0	-	4.0	-	4.0
South Waghi District	10.0	-	4.0	0.2	3.8
Tambul-Nebiler District	10.0	-	4.0	0.4	3.6
	890.0	**-**	**356.0**	**43.8**	**312.1**

Source: Department of Finance

Further detail of expenditure from Supplementary Budget Trust Accounts can be obtained from the 2008 Mid Year Economic and Fiscal Outlook Report (MYEFO).

CHAPTER 4. 2009 BUDGET TAXATION MEASURES

4.1 OVERVIEW

The main tax policy initiative in the 2009 Budget is to enhance the existing large scale tourism accommodation incentive. The enhancements are aimed at further encouraging investment in the tourism industry by increasing the period of time over which the concessional company tax rate of 20 per cent is applied and by relaxing the eligibility requirements.

The 2009 Budget also introduces minor tax policy and technical amendments to improve tax compliance, remove unintended errors, overcome interpretational issues, remove minor distortions and to clarify the operation of the law.

The taxation measures in the 2009 Budget have been framed in the context of substantial falls in commodity prices and the global financial crisis, which have significantly reduced the revenue estimates for 2009.

4.2 2009 TARIFF REDUCTIONS PROGRAM

Following the review of the Tariff Reductions Program in 2007, the Government announced it would consider further tariff reductions in 2009.

Given the uncertainty and volatility currently surrounding the economic outlook, consideration of further tariff reductions has been deferred until 2010 when the economic outlook is expected to be more settled.

4.3 ENHANCEMENT OF EXISTING INCENTIVES TO THE TOURSIM SECTOR

The Government will enhance the existing tax incentives for large scale investments in tourism accommodation, which were introduced in the 2007 Budget. The current incentives include:

- A higher accelerated depreciation rate of 55 per cent;
- A concessional company tax rate of 20 per cent for the first ten years of operation;
- Double deductions for staff training expenditure;
- Infrastructure tax credits equal to 1.5 per cent of gross income; and
- An exemption from GST for the purchase of travel and accommodation by foreign tourists prior to arrival in PNG.

Currently, recipients of the large scale tourism accommodation incentive receive a higher rate of accelerated depreciation, which will generally result in tax losses in the first few years of operation. As a result, the concessional corporate tax rate (which only applies for 10 years) is not effective until the initial year loss has been recouped in subsequent tax years.

In recognition of this, and to further encourage investment in large scale tourism accommodation, the Government will increase the period of time over which the concessional company rate applies from 10 to 15 years.

In addition, the Government will relax the eligibility criteria to access the large scale tourism accommodation incentive. This will further encourage tourism developments, where investments are on a smaller scale. The Government will reduce the minimum capital requirement from US$10 million to US$7 million and the room requirement from 150 to 100 rooms.

4.4 TAX CONCESSIONS

Though there will be no new tax concessions in the 2009 Budget, efforts to facilitate and encourage investment continue. In addition to the significant amount of funds directed towards key priority areas such as rehabilitation and maintenance of public infrastructures and maintaining law and order to ensure a conducive environment for private investment, the Government also has in place a number of general tax concessions.

These concessions are available to all sectors of the economy and include:

- The Research and Development Incentive, which provides a 150 per cent income tax deduction for expenditure on Research and Development;

- The Double Deduction for Staff Training Costs, which provides 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 institution or prescribed tertiary institution;

- The Duty Drawback, which provides a rebate to manufacturers on exported goods equal to the amount of duty paid on new materials;

- The Export Sales Exemption, which provides an exemption from company tax for income derived from exports of prescribed goods for the first three years, and for income from the increase in export sales for the following four years; and

- Accelerated and Flexible Depreciation, which allows for capital assets to be written off at a faster rate than their effective life.

4.4.1 Existing tax concessions

In the past, tax concessions have been granted on a project basis through project agreements. This is not the preferred tax policy approach. Tax concessions should instead be made available on an industry wide or sectoral basis to create a level playing field for competing firms in an industry.

There is also a growing concern that project agreements contain general tax concessions that are provided in the existing law. The Government is embarking on an awareness campaign to inform stakeholders of the various tax concessions available. Existing fiscal concessions have been compiled to assist stakeholder awareness of sector-specific and general concessions. These concessions are available in law and there is no need for investors to seek to have them included in project agreements.

4.4.2 Maintain the integrity of the Tax Base

To ensure that future budgets are supported by a consistent 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 will ensure neutral and equitable tax treatment of projects in each sector, and transparency in tax policy.

Furthermore, the assurance and certainty of equitable treatment for all investors encourages further investment in the economy.

4.5 MINOR POLICY AND TECHNICAL AMENDMENTS

In order for the tax administration to be compatible with modern ways of doing business and changing taxpayer behaviour, the Government continues to introduce minor policy and technical amendments in the annual budget. The 2009 Budget includes minor policy changes to improve tax compliance and increase the administrative efficiency of the Internal Revenue Commission. The technical amendments are intended to remove minor errors, overcome interpretational issues and clarify the operation of the law.

4.5.1 Minor Tax Policy Changes

- Amend the Customs Act to discourage smuggling by increasing the load limits of vessels that can be seized by Customs from 250 to 500 tonnes, and extend customs control in territorial waters from 3 to 12 nautical miles in order to be consistent with the National Seas Act;

- Amend the Customs Act to empower the courts to impose an additional penalty for smuggling dutiable goods, counterfeit goods and excisable goods which is related to the value of customs duty that has been avoided and the value of the smuggled goods;

- Amend the Income Tax Act to include Sections 247A and 247B to clarify the way the National Court will hear appeals to a taxpayer's objection with the Commissioner General's decision relating to an income tax assessment. This amendment imposes a duty of disclosure on the taxpayer to ensure that the taxpayer and Commissioner General have the same information before the court; and

- Amend Section 364 of the Income Tax Act to oblige taxpayers to retain records for seven years after lodging tax returns (instead of seven years from the transaction date). This amendment will promote fairness to all taxpayers and ensure there is an incentive to lodge tax returns in a timely manner.

4.5.2 Minor Technical Amendments

- Amend Income Tax Act to define "Public Authority";

- Amend Section 24 of the Income Tax Act to remove an incorrect reference to Provincial and Local Bodies;

- Amend Section 16A of the Stamp Duties Act to prevent stamp duty avoidance when entering into two or more agreements for the same transaction between the same or related parties;

- Amend Section 48(C)(1)(c) of the Stamp Duties Act to clarify the existing law and achieve the original policy intent where portions of the same property are sold to the same or related parties; and

- Amend Section 101(2) of the Stamp Duties Act to insert the correct abolishment date for duty on insurance policies of 1 April 2008.

CHAPTER 5. BUILDING THE ECONOMY THROUGH SUSTAINED REFORM

5.1 OVERVIEW

The Government recognizes that the private sector is and will continue to be the engine of economic growth for PNG.

While the Government is working to improve the regulatory environment and reduce/remove impediments to doing business and investment, PNG still lags behind other similar developing countries in terms of ease of doing business. According to the World Bank's *Doing Business 2009 Report* which investigates the regulations affecting business activity, PNG is ranked 95th among the 181 economies assessed. This is the fourth consecutive year PNG has slipped down the rankings with it now even lagging behind Fiji, Vanuatu, Tonga, Samoa, Kiribati, Solomon Islands and Palau. This situation needs to be improved.

The 2009 Budget will continue to promote the Government's initiatives to undertake reforms in critical sectors of the economy through enhancing competition and maintaining a stable investment climate in order to promote private sector growth.

Further, the Government will continue to improve the efficiency, effectiveness and affordability of the public sector through reforms on public service numbers, the payroll system, best practices and transparency in financial management at all levels of Government.

The Government has taken practical steps in improving financial information and communication technology in order to support the whole of government financial management systems. Significant progress has been made in improving financial management in recent years and further reform in this regard will be explored.

In 2009, the Government will continue to pursue improvements in expenditure control through the ongoing implementation of the Public Expenditure Review and Rationalization (PERR) program. The Government recognizes the importance of continuing the district treasury roll out program and will continue with it in 2009 to provide government financial services and to complement the provision of basic services to rural areas under the enhanced District Service Improvement Program (DSIP).

5.2 STABLE INVESTMENT CLIMATE

Creating a stable investment climate is one of the key elements required to achieving a strong economy. There are number of critical cross-cutting issues which are impeding private sector growth. The major ones include poor transport infrastructure; inefficient utility service provision (telecommunications, water and electricity); high transport costs; law and order problems; and land tenure issues. Political stability and the resulting greater consistency of policies are also very important for investment growth. These issues are indeed great challenges for the Government to address to enable economic growth over time.

Over the last few years, there has been a significant improvement to the Government's fiscal and debt position due to good fiscal and macroeconomic management and the

Government's adherence to a range of medium-term policy frameworks, particularly the Medium Term Fiscal Strategy and the Medium Term Debt Strategy. Nevertheless, inflation grew to double digit levels during 2008 and this needs effective monetary and fiscal policy action to bring inflation back to more comfortable levels. In 2008, the Government has adopted a new Medium Term Fiscal Strategy (MTFS) 2008-2012, which provides the principles for allocating any additional mineral revenue to the best uses for improving PNG's long-term future. The new MTFS 2008-2012 will guide the Government's expenditure decisions when allocating additional mineral revenue. A 70:30 rule will apply in the allocation of windfall revenue – 70 per cent will be used to pre-fund future one-off additional public investments and 30 per cent to be used for public debt repayment.

The opportunities for investment in PNG are abundant. The proposed LNG projects may also bring in more potential investments if they proceed.

5.2.1 Fiscal Responsibility Act

The *Fiscal Responsibility Act* was enacted in 2006 to promote economic and financial transparency and accountability. It strengthens the medium-term framework for fiscal policies and provides guiding principles for the conduct of fiscal policy for the Government.

The Treasurer has authority under the Act to approve borrowings undertaken by Government agencies. In addition, the Treasurer will be consulted on any submission to the National Executive Council (NEC) that has financial implication for the State, prior to consideration of the submission by the NEC.

As required under the Act, the Department of Treasury has been on target in releasing the three fiscal reports: the Final Budget Outcome (FBO) report; the Budget Strategy Paper (BSP); and the Mid-Year Economic and Fiscal Outlook (MYEFO) report. All these reports were completed and released in 2008. The 2007 FBO report was completed and released in March 2008, followed by the 2009 BSP in July, and finally the 2008 MYEFO was released in July. This is a significant achievement in the Government's attempts to increase the transparency and accountability of its fiscal operations.

5.2.2 Affordable and Sustainable Wages Policy

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

In 2007, the Government negotiated a salaries and allowances agreement with the Public Employees' Association (PEA) after the 2004 Agreement expired. The new Memorandum of Agreement covering the three years period from 2007 to 2010 was endorsed and signed by the Government in December 2007. The productivity benefits flowing from the Agreement include a reformed Performance Based Salary Structure (PBSS) to strengthen the performance management system and address absenteeism and attendance problems by establishing attendance criteria as a prerequisite to increment progression; and introduction of flexible working arrangements, including permanent part-time employment and flexible hours of duty.

In 2008, the Government concluded negotiations with the Papua New Guinea Teachers Association (PNGTA) on the next *Memorandum of Agreement for the Determination of Salaries for Teachers* for the period 2008 to 2010. The agreement was endorsed and signed by the Government in November 2008.

Also in 2008, the Government re-established the Minimum Wages Board (MWB) to review and address the current minimum wages level. In determining a safety net for the low income earners, it is very important to consider the impact of an increase in minimum wages on the economy, particularly any adverse effects on inflation, employment and PNG's international competitiveness. The MWB has convened and conducted its hearing into submissions from the unions and employee representatives throughout the country. The final report and its recommendations is expected to be released in early 2009.

5.3 A COMPETITIVE AND DYNAMIC PRIVATE SECTOR

The Government is committed to promoting a competitive and dynamic private sector, and acknowledges the positive contributions this can have on the economy through creating employment, higher incomes and stimulate economic growth.

In 2009, the Government plans to undertake a range of activities to enhance competition and private sector growth. The structural reform and competition policy agenda for a range of key sectors is outlined below.

5.3.1 Enhancing Competition

The benefits of increasing competition are many but it is particularly important for increasing efficiency, productivity, reduces prices, improves quality of service delivery and promotes innovation. The Government realizes the benefits of competition and its impact on the economy hence will continue to undertake a number of initiatives to improve competition in key service sectors of the economy.

The Government will continue to create an enabling environment for competition by removing impediments which affect fair competition. Some of the important areas in which good progress has been made or is being made in this regard include removing monopoly powers, reducing burdensome regulation, tackling difficult licensing procedures and various other protective measures.

Since 2006, the ICCC has conducted important reviews into the aviation, coastal shipping, tourism and the telecommunications industries. In addition, comprehensive competition reviews into the General Insurance industry as well as the Wholesale and Retail trading sectors have been held with a particular focus on the level of competition and the premium and profit margins within these industries.

5.3.1.1 Telecommunications

Since the introduction of competition in the mobile segment of the industry in 2007, 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 continues to grow rapidly from around one hundred thousand subscribers in 2006 to an estimated one million in 2008, with an increasing proportion of the population having access to telecommunications services. This represents a large and rapid overall improvement in market penetration of mobile services. Significant cost savings have also been realized by users of mobile services, together with a much wider geographical area of coverage.

Competition has improved efficiency and reliability of mobile phone services, lowered prices of mobile phone calls, significantly increased employment and has injected a substantial amount of capital into the economy, significantly contributing to GDP growth in recent years. The expansion of mobile phone services in PNG - from both Digicel and PNG Telikom - is

estimated to have contributed around two and a half percentage points to GDP growth in the last couple of years.

Following from the successful introduction of competition in the mobile telecommunications sector, the Government reaffirmed its commitment to the staged introduction of open competition in the telecommunications sector in combination with the transformation of Telikom into a viable and efficient competitor upon the introduction of competition.

Phase 1 has involved the introduction of two mobile licences, one of which has commenced operation. Phase 1 maintains the role of Telikom as the sole holder of a general carrier licence and exclusive rights to operate the international gateway by which telecommunications networks in PNG are connected to international networks.

Given the successful implementation of phase 1, attention will now turn to developing the timetable and reform agenda for phase 2 of the introduction of open competition in the ICT sector.

5.3.1.2 Aviation

In recent years, PNG has experienced improvements in aviation services, both in relation to regulation by the Civil Aviation Authority (CAA) but also the airline industry itself. This improvement is mainly attributed to the Government's commitment to reform of the CAA and greater competition in the aviation industry. The Government hopes to build further on these gains in 2009.

As with the code sharing arrangement between Air Niugini and Qantas, Airlines of PNG and Pacific Blue Limited have commenced a code sharing arrangement. The entry of an additional airline into PNG's aviation industry will continue to promote the benefits of competition, with reductions in the cost of fares and increased services for international travelers. This addition is expected to produce benefits for the tourism sector and will hopefully generate additional income earning opportunities for Papua New Guineans.

The Government's initiative to corporatise CAA is progressing well and has led to some improvements in the Authority's functions. Initiatives to separate the commercial functions of the CAA from its regulatory and safety functions are also making good progress. The 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.

5.3.1.3 Electricity

Reliable and consistent electricity service provision is important for business operations and the many people who depend on it. However, frequent electricity outages cost businesses and households significantly and result in loss of production and add costs to business operations.

The Government hopes to expand the opportunity for investment to improve the provision of reliable electrical services. Accordingly, it is preparing a National Electricity Policy, which focuses on private sector participation and competition, particularly in generation activities and rural electrification.

The National Electricity Policy is being prepared by an inter-departmental task force to guide the development of this industry into the future. The 2008 Budget provided an additional K30 million for rural electrification to be allocated according to the soon-to-be finalized electricity

policy. This will be the basis for moving forward in increasing efficiency of electricity service provision.

5.3.1.4 Tourism

In 2007, the Government adopted the PNG Tourism Master Plan 2007-2017, which identifies the tremendous potential which PNG has to further develop this sector. It recognizes that tourism offers a sustainable alternative to the traditional resource based industries of PNG and as such is an investment in the long-term economic, social and environmental welfare of the country. For the first time, the Tourism Master Plan provides the basis for a comprehensive and 'whole of Government' approach to the development of the sector.

A key recommendation of the review is the separation of the policy and marketing functions of the Tourism Promotion Authority (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 for establishment 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's recommendations.

In 2008, the Ministry of Culture and Tourism commenced a review of the institutional arrangements within its portfolio. The review aims to assess the current institutions in the portfolio (PNG Tourism Promotion Authority, the National Cultural Commission and the National Museum and Arts Gallery), their linkages, and their capacity. This is with the aim of proposing an appropriate structure which could help support and enhance the growth of tourism and culture, both at the national and provincial levels and foster a more effective partnership and collaboration between the institutions.

The ongoing reform in the tourism sector is important in complementing and supporting the Government's efforts in improving the sector.

5.3.1.5 New Reviews

The Government also plans to undertake reviews of key sectors to identify possible impediments to competition and opportunities for private sector development in various sectors.

As an independent regulator, the ICCC has an important role to play in relation to such reviews. As in 2008, the ICCC will continue to undertake further reviews of the current price regulation relating to petroleum products, sewerage and water services in 2009. The review into pricing of Water and Sewerage services will form a broader review endorsed by the Government.

The ICCC was also tasked by the Government in 2007 with undertaking a comprehensive review of competition and market conduct in the General Insurance industry. 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 in order to move forward. The Department of Treasury will continue to consult with stakeholders in the insurance sector to identify opportunities to address the concerns identified in the review and to seek to enhance competition and regulation in the insurance industry.

Further sectoral reviews will be identified throughout 2009 as part of the Government's ongoing commitment to competition policy and structural reform.

5.3.2 Improving Public Infrastructure

The Government is committed to building and improving public infrastructure throughout the country in 2009. In this, transport infrastructure rehabilitation and maintenance is crucial to allowing accessibility to markets, which is important for the bulk of the population in rural areas.

Accordingly the Government is committing substantial funds to public infrastructure in the amount of K954.4 million in this Budget.

These expenditures build on the substantial investment made by the Government in public infrastructure in recent years, including the total investment of K636.8 million in the 2008 Supplementary Budget and K1,082.1 million in the 2008 Budget.

Over K435 million has been allocated in the 2007 Budget and K1,378 million in the 2006 and 2007 Supplementary Budgets for infrastructure development. The Government will continue to improving public infrastructure in future by allocation more funds in this area of great need.

5.3.3 Removing Impediments to Business and Investment

Removing barriers to private sector investments is key to promoting and providing a conducive environment for private sector growth. The barriers are many, including those that are mentioned above, and range from inappropriate and overly burdensome regulation to cumbersome administrative procedures and processes.

The Government has made some progress in addressing issues in this regard, focusing on removing impediments to business in order to boost business confidence and encourage investment and growth in the economy by improving burdensome regulations that constrain business activities.

The reinvigoration of the "National Working Group" on Removing Impediments to Business and Investment in late 2008 is an important step forward for the private and public sectors to continue working as partners in identifying and addressing private sector issues. Some of the issues that have been considered and addressed previously under the National Working Group include efforts to reduce the number of days it takes to start a business, the Investment Promotion Authority's foreign investment certification process, improving employment visa services and liberalization of the foreign exchange controls. In 2009, the Government will continue to address impediments to business and investment in PNG.

In recognizing the importance of maintaining a sound financial sector, the Government continues to support and strengthen the regulatory reforms in the financial sector, especially in the superannuation industry. This will enhance effective regulation and prudential supervision of this industry by promoting and fostering improvements in governance.

5.3.3.1 Housing Policy

The Government established a Technical Working Committee tasked with developing a National Housing Policy in March 2007. The National Research Institute (NRI) was engaged as a Strategic advisor to the Taskforce and has assisted in coming up with a National Housing Policy and Strategy. The Taskforce has consulted widely in the preparation of the policy which is now awaiting NEC consideration.

The housing issue cuts across a number of key factors and these include: availability of land and security of title, the limited supply of housing, and the need for further private sector involvement in housing construction and management.

A total of K62 million was allocated in the 2007 and 2008 Supplementary Budgets and 2008 Budget towards institutional housing and housing development schemes. The Government will ensure that these funds are allocated in a sustainable manner that addresses the core housing issue related to the lack of supply of available land and houses.

A commitment to the housing issues also requires improvements in the operations and performance of the National Housing Commission. The Government is currently developing options for the review and reform of the NHC to ensure the Government's investment in housing is appropriately managed.

5.3.3.2 Tariff Reduction Program

The planned implementation of a further Tariff Reduction Program (TRP) has been delayed as a result of the international financial crisis and the sharp fall in commodity prices and large movement in exchange rates. These international developments have created a lot of uncertainty and volatility and the implementation of the TRP is now deferred until 2010. By this time, there should be a more stable environment which would be more conducive for any changes to be made to the tariff structure.

5.3.4 Public Private Partnerships (PPPs)

The Government supports and values the contribution of the private sector as an important development partner in nation building. To promote and enhance the private sector, the Government is in the final stages of formulating a Public Private Partnership (PPP) policy, which is intended to strengthen cooperation between a public institution (that is, a line agency, SOE or lower level government) and one or more private enterprises in the provision of infrastructure. The objective of a PPP is primarily to enhance infrastructure and services delivery by utilizing private sector capital, management, innovation, technology and other resources.

In April 2008, the Asian Development Bank (ADB) and the Government entered into a Memorandum of Understanding (MOU) on technical assistance to support the design of a national PPP Policy. The policy is currently being developed and following consultations is expected to be submitted for consideration by the NEC.

The PPP concept is viewed as a potential mechanism for addressing PNG's implementation and capacity constraints. The PPP model could provide the project management skills necessary to deliver projects, particularly in areas where funding has already been set aside in trusts, such as health and education infrastructure. In doing so, the PPP model provides an avenue to address some of the criticisms and impediments levelled at the SOEs.

The national PPP Policy set the guidelines to engage with the private sector on the provision of physical and social infrastructure programs in support of the Government's developmental objectives. The PPP Policy will help leverage the financial, managerial and technical resources/expertise of the private sector in the delivery and or management of such infrastructure.

There are, however, some risks associated with the PPP policy that must be carefully managed. In particular, the policy must be consistent with the government's financial management frameworks and be transparently implemented. Accordingly, these and other issues are being carefully considered as part of the policy development process.

5.4 PUBLIC SECTOR REFORMS

5.4.1 Streamlining Public Sector Resource Allocations

The Government is committed to improving and sustaining its fiscal performance through the Public Expenditure Review and Rationalization (PERR) program, which is coordinated by multi-agency Implementation Committee (PERRIC), and also involves development partners. In terms of the PERR objectives, much has been achieved to date. However, there are some aspects of the reform which are progressing slowly or are yet to take place. The Government will continue to implement this reform.

As a strategy to move forward on the next phase of the Public Sector Reforms, an external review of public sector reform programs was undertaken by the Public Sector Reform Management Unit (PSRMU). A series of seminars and discussions with various agencies and stakeholder including CACC and the National Planning Committee (NPC) took place as part of a wider consultations and awareness regarding the Public Sector Reform Strategy 2008-2012. The findings of the review have formed the basis of a Road Map on this public sector reform. The Strategy has also been refined to take into account the Government's 40 year National Development Plan.

5.4.2 Public Sector Reform Strategy

In order to complement and build on from past reforms to improve service delivery, a *Public Sector Reform Strategic Plan 2008-2012* has been developed. This plan focuses on addressing poor service delivery through two strategic goals:

(i) Improving the delivery of basic services to districts, local level government, wards and communities; and
(ii) Supporting service delivery by creating a high performing and affordable Public Sector, including identifying other innovative service delivery mechanisms to boost service delivery.

The first strategic objective will involve targeted actions to address key generic and sector specific impediments to service delivery at the district and community levels. The second strategic objective will involve improving core public sector systems and processes to enable the public administration to support service delivery more effectively.

The *Public Sector Reform Strategic Plan 2008-2012* is different from the past reform plans by focusing on improving service delivery at the district and community levels. This plan is one of the major pillars of the Government's *Long Term Strategic Plan 2010-2050*. The whole of government reforms to be pursued under the long-term plan will provide

opportunity for the necessary structural adjustments that are critical for effective and efficient service delivery mechanism that will improve the quality of life for our people.

5.4.3 Equitable Resource Allocations to Provincial Governments

In July 2008, Parliament approved a package of reforms to the *Organic Law on Provincial Governments and Local Level Governments* that has changed the system of intergovernmental financing, commencing with the 2009 Budget. The new system affects all provinces, except the National Capital District and the Autonomous Region of Bougainville, which are both subject to separate legislation.

The new system will continue to introduce a number of service delivery function grants for recurrent goods and services. Those continuing from the previous system include Transport Infrastructure Maintenance, Health, Education and Village Courts Function Grants. The former Block Grant is now split into an Administration Grant and an Other Service Delivery Function Grant. The Derivation Grant has now been replaced by the Agriculture Function Grant. All Local Level Governments (LLGs) will now receive either an Urban LLG or Rural LLG grant.

The key features of the new system are:

- GST will continue to be distributed to provinces according to where net inland GST is collected, but they will now receive a standard 60 per cent of 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 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 fully implemented, all provinces should have the financial capacity to meet at least 70 per cent of their service delivery needs.

- Total funding available to provinces and local-level governments for goods and services will be set as a fixed proportion of net national revenue (total revenue, less volatile mining and petroleum revenue). This approach ensures that, as 'normal' revenues rise, funding to provincial and local-level governments will increase in an affordable and sustainable way.

- Additional funding will be phased in over the first five years of the new system. For 2009, this is equal to K37.5 million. During this five year transition period, no province or local level government will receive less than it did in 2008.

These changes will make the system of provincial and local-level government funding more equitable, and provide increased assistance to provincial and local-level governments towards the costs of basic service delivery.

5.4.4 District Services Improvement Program (DSIP)

The District Services Improvement Program (DSIP) is designed to improve or have basic government services throughout the entire 89 districts of the country. The program is

focused on the provision of funding towards basic infrastructure rehabilitation and maintenance at the district level.

In pursuing development priorities for PNG, the Government provided a total of K890 million from the 2007 Supplementary Budget and the 2008 Budget of which each district was allocated a one-off K10 million for priority expenditure areas.

The Government has expanded the DSIP by allocating an additional K4 million to each district in 2009 to continue pursuing its ambitious development priorities. Accordingly, a total of K356 million has been appropriated in the 2009 Budget for this expansion.

5.4.5 Improving Governance and Accountability

This year, the Department of Personnel Management (DPM) delegated certain powers and responsibilities of managing human resources to Government departments under its devolution program. These powers include: organizational structuring; selection and recruitment; contract administration; discipline; training; retirement and retrenchment. Appropriate funding will be required to ensure effective implementation of programs by the agencies.

The Government is also committed to improving governance and accountability at the lower levels of government. A MOU was signed with the European Commission to strengthen District and Local Level Governments (LLGs) throughout the country. The program will support and strengthen the functioning of Districts and LLGs for effective service delivery for broad-based socio-economic development. The program has four components:

(i) Grant facility to strengthen capacity and development initiatives at District and LLG levels with emphasis on physical infrastructure and capacity;

(ii) Support training and capacity building with emphasis on systems and processes and manpower skills;

(iii) Management support to the Department of Provincial and Local Government Affairs;

(iv) Support to strengthen governance initiatives with emphasis on supporting existing institutions including Parliamentary Committees, Ombudsman Commission and initiatives that promote good governance at the national level.

The project is expected to lead to improved capacity, accountability and an improved overall framework for effective functioning of the lower levels of government.

5.4.6 Improving Governance and Accountability of Resource Rich Provinces

The Government is concerned about direct transfers from extractive industries to provincial governments, as accountability and disclosure of accurate reporting on these transfers are lacking. Accurate reporting and transparency of these transfers and receipts at the provincial level are needed as part of monitoring purposes by the National Government and to prevent leakages from provincial accounts. As a way forward, the Government held initial discussions with donor partners on Extractive Industries Transparency Initiatives (EITI) to address these critical issues in a carefully planned and coordinated manner.

The Government is very supportive of this work in partnership with the World Bank and ADB in addressing the transparent use of transfers from extractive industries to the provinces in 2009. As part of the EITI transparency initiative, the World Bank funded Mining Sector Technical Assistance 2 Project (WBTA2) through Mineral Resources Authority (MRA) will be addressing the transparent use of transfers from extractive industries to the provinces/recipients in 2009 by posting such transfers on the MRA website (www.mra.gov.pg). All figures will be verified by the various parties prior to public release.

The MRA is in the process of undertaking consultation with provinces and recipients such as those identified under the MRA respective mining project MOAs on this disclosure requirement.

5.4.7 Civil Service Size and Payroll Reform

A key objective of the public sector reform is to reduce the size of the public service payroll. An external review of the PERR highlighted two concerns in relation to the effectiveness of payroll controls. These relate to breaches in the controls over payroll records where individuals in data entry areas can access and change records. Effective controls and management of payroll records are required.

Data cleansing of payroll in national agencies and provincial administrations remains an area of concern. The Department of Personnel Management (DPM) has plans to conduct further data cleansing of payroll in national agencies and provincial administrations ensuring that staff on strength matches with approved manpower ceilings.

5.4.8 Improving Financial Management through Integrated Financial Management System

The present legacy of the Planning and Budget System (PBS) will be replaced by the Integrated Financial Management System (IFMS) which will provide the functionality for setting hard ceilings, preparation of the annual budget, execution and maintenance, accounting and reporting which would form the General Ledger.

The system will be piloted in the Central agencies: Department of Treasury, Finance, and National Planning & Monitoring. It will then be rolled out to Works, Health and Milne Bay and to other national agencies in the National Capital District after testing and acceptance process is executed that meets the Government’s functional operating requirements which were specified for this integrated system.

5.4.8.1 Medium Term Financial Management Strategy (MTFMS)

The Government has recognized the need to have an overarching Framework for Public Financial Management reform with the development of the Medium Term Financial Management Strategy (MTFMS). The development of this strategy has progressed in 2008 through a working group that conducted wide consultation with stakeholders both at the National and Provincial level including our development partners and further reform is in prospect for 2009.

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 improve the present planning budget system and financial accounting and provide a mechanism for improve monitoring and reporting on public sector financial management and accountability at all levels of government.

5.4.8.2 Better Expenditure Control

The PERR program implemented by the National Government will continue in 2009 and into the immediate future in the areas of public funds expenditure control. Under this program, project 9 relates to adoption of a proper framework to better control expenditure through making some amendment to the Public Finance (Management) Act and having these applied in all public bodies that collect and hold public assets on behalf of the government.

5.4.8.3 Audit Committee and Internal Audit functions

Another major key initiative by the National Government is to improve corporate governance through strengthening and establishment of internal audit and audit committee functions. A key outcome from the effective operations of the internal audit and audit committee functions is compliance of laws, procedures and standards. The focus of both functions is to ensure effective and efficient operations of systems and processes for better management of public moneys and provision of public goods and services.

To date, 17 audit committees have been established across national departments, statutory authorities and provincial government levels. In 2008, the committees have conducted most of the scheduled meetings and it looks promising that they will improve and be more effective in the years ahead with adequate administrative and resource support. The Department of Finance is still pursuing discussions and consultation with the agencies to strengthen these functions. The initial awareness is still continuing in other Government organizations for launching of new audit committees.

5.4.8.4 Financial Reporting, Payroll and Trust Reforms

The main accounting systems of the Government of PNG managed by the Department of Finance include Payroll Accounting, General Ledgers, Payroll Maintenance and Trust Accounting from which public accounts are produced for each fiscal year annually.

The Auditor General has completed the 2006 Public Accounts and once the audit opinion is concluded, this together with the Public Accounts will be published. The audit on the 2007 Public Accounts is underway.

The Government will continue to rationalize the number of trust accounts to improve the way they are managed. Over the last two years the number of trust accounts for the public accounts has been reduced significantly, both in national and provincial departments and this exercise is ongoing. The 2006 and 2007 Supplementary Budgets, however, dictated the need for new trust accounts which were established in close consultation with the Department of Treasury, National Planning and the Prime Minister’s Department.

5.4.8.5 District Treasury Rollout Program

The Department of Finance has been implementing the Government’s District Treasury Rollout Program since its inception in 2004. So far fifty one (51) District Treasuries have been launched. These Districts are currently providing financial management services to the Local Level Governments, District Administrators and other stakeholders based in the Districts. They also provide public telephone services, postal services and banking services to the local communities in the districts.

The balance of thirty five (35) District Treasuries will be launched in the 2009 financial year.

A proposal to establish four (4) Regional Offices in the four regions of the country has been given funding in the 2008 Supplementary Budget. Arrangements are in place to get the Central Supply and Tenders Board to deliberate on the projects.

5.4.8.6 Non-Tax Revenue Management

Project 8 of PERR program is directed at improving non-tax revenue collection.

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

Work to be undertaken in 2009 includes:

- Installation of Computerized Receipting System (via PGAS) in all the Provincial Treasuries.
- Development of a Revenue Training Module which will cover Revenue Management Controls under the Financial Management Manual.
- Installation of Electronic Funds Transfer at Point of Sale (EFTPOS) outlets in all the Provincial Treasuries and other revenue collecting sites.
- Opening of Receiver of Public Monies accounts in PNG foreign missions for collection and reporting of migration service fees separately.
- Appointment of Collectors and Receivers of Public Monies in other Departments to come under the direct responsibility of Department of Finance.
- Involving and networking with the Provincial Support Advisor to link departments in the provinces with the provincial treasury operations at the provincial level.
- 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 by five (5) Departments.

5.4.9 Strongim Gavman Program (SGP)

Following a joint review of the Enhanced Cooperation Program (ECP) by the PNG and Australian Governments in 2007, the joint PNG and Australian Ministerial forum agreed to rename the ECP as the Strongim Gavman Program (SGP) in 2008, with the SGP having a greater focus of attention on capacity building.

The SGP promotes and enhances good governance, sound financial management administration and capacity building within the PNG public sector. Through the placement of skilled and experienced Australian public servants into government agencies, the program has strengthened the capacity of those agencies and enhanced bilateral ties between both governments. The program focuses on the economic and public administration, law and justice, transport and border security sectors of the PNG public sector.

5.4.10 Statutory Authorities

Statutory Authorities have responsibilities delegated to them by the national government to perform their respective governmental functions through the provision of public goods and services. The rationale behind the establishment of Statutory Authorities has been to achieve greater independence from the Government and increase efficiency in their management and service delivery roles.

However, the Government's concern for some time now has been that Statutory Authorities have not complied with the PFMA in terms of submitting their annual financial statements in a timely manner.

To ensure compliance, the government has undertaken some reviews with technical assistance from donor agencies.

The World Bank's review in September 2005 recommended amending the PFMA to improve financial management and governance of Statutory Authorities. Consequently, an inter-agency team was set up to look into these issues.

The ADB provided technical assistance to assist in this work going forward. Their report provided a number of recommendations for the reform of the governance of the Statutory Authorities including proposed amendments to the PFMA. One of the key recommendations is for the current accountability regime to be strengthened by enhancing the enforcement provisions contained in Part VIII of the PFMA, and introducing an Annual Performance Agreement (APA) to improve the accountability of Statutory Authorities to the Government.

The Final Report will be finalized and submitted to the NEC for approval and the key recommendations to be implemented.

5.4.11 Land Reforms

Clear ownership and effective management of land is central to economic development. In Papua New Guinea, the complexity involved in accessing customary land for development and the ineffective land administration system have been the major impediments to economic growth.

A National Land Development Program (NLDP) was formulated based on the National Land Development Taskforce (NLDT) recommendations to identify problems and issues relating to land.

There are four components to NLDP:

- (i) the organization reform of the Department of Lands and Physical Planning;
- (ii) reform and technical strengthening of land administration;
- (iii) customary land development; and
- (iv) Land Legislation and dispute Settlement.

The Government is committed to the implementation of the recommendations of the National Land Development Taskforce on land reform, particularly improving the process for conversion of unregistered customary land to registered customary title and then to urban development leases. This process requires substantial streamlining of current processes and requires further leadership from Government and stakeholders to see tangible improvements in land management and land availability.

CHAPTER 6. DEVELOPMENT STRATEGY

6.1 MEDIUM TERM DEVELOPMENT STRATEGY

The Medium Term Development Strategy (MTDS) 2005-2010 was introduced in 2005 to articulate an overarching development strategy for PNG that could provide a framework to guide the Government's development expenditure and serve as a guide for resource allocation and mobilisation. The strategy is based on export-driven growth, rural development and poverty reduction by means of promoting good governance and promoting key industries in which PNG has a comparative advantage on a sustainable basis. The MTDS identifies seven Expenditure Priority Areas (EPAs) to guide public expenditure. Adherence of public expenditure to these seven EPAs will ensure that the MTDS is reflected in the Budget.

The seven EPAs are:

- 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

The seven EPAs are the spending priorities for the Government, because they 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.

While the MTDS outlines the major reform programs – Public Sector Reform, Public Expenditure Management, Macroeconomic Management, Governance, Environmental Protection, Gender Equality – these do not require significant public expenditure. Instead they require other solutions, such as stronger leadership, better policies and legislative reform.

6.2 2009 DEVELOPMENT BUDGET STRATEGY

The 2009 Development Budget aims to improve economic growth and create wealth for the majority of Papua New Guineans. Medium term forecasts indicate slowing economic growth. The Government has therefore decided to take deliberate policy decisions to increase investments in the non-mineral sector of the economy and to create the opportunities that allow people in rural areas to participate in and benefit from the growth process.

The 2009 Development Budget recognises that improving economic opportunities and providing other essential services, can only be realised if the supporting infrastructure is in place. Improving infrastructure is critical in increasing the mobility of services, goods and workers. Only if workers can move to where there is work available, workers can move their goods to the market place and Government-provided services can reach the people, will the rural sector be transformed.

Much of the economic growth of the country is rural driven. Because the majority of the people live in rural areas, in order to ensure that they benefit from growth is to provide the rural areas with opportunities for economic activity and higher levels of productivity. The 2009 Development Budget strategy aims to increase the income of the people in rural areas. The income of the people in rural areas will increase if the value of their assets increases – their land and their labour. Therefore the opportunities must exist to enable rural people to access markets, to increase their skills and to improve the productivity of the agricultural industry.

Furthermore social indicators, particularly in rural areas, are worrying. Health and education services must be improved to improve the quality of life in rural areas and to enable the people to be able to become productive participants in the country's development. Government must therefore put the necessary social infrastructure in place and strengthen service delivery mechanisms at the lower level.

Only once transport infrastructure effectively links up the country and the majority of people have access to basic education and health services, will the foundation be in place to start promoting more advanced development goals. Promoting the agriculture industry in the medium term will not only increase the incomes of people in rural areas, but also increase the potential for exporting, increase food security and provide a strong basis for the growth of other downstream processing industries with essential inputs. In this way the 2009 Development Budget lays the foundation for the proposed Long Term Development Strategy (2010-2030).

Therefore while the 2009 Development Budget Strategy still focuses on the seven EPAs it has a different prioritisation of the EPAs than previous Development Budgets in order to promote rural empowerment and sustainable transformation. This approach to achieving rural empowerment and transformation through the Development Budget is structured around three considerations:

1. How the Budget can be aligned with the MTDS;
2. How expenditure should be spread across the seven EPAs to maximise the social and economic returns; and
3. 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 in the 2009 Development Budget requires that the proportion of the Budget allocated to the MTDS increases every year. A target has been set to increase MTDS alignment of all GoPNG expenditure (i.e. direct financing, tax credit and loans) from 48 per cent in 2005 to 55 per cent by 2010, when the current MTDS expires. For 2008, the alignment figure was 55.5 per cent and the target for 2009 is to at least maintain this figure.

A separate target is set for development expenditure. In 2008, 82.7 percent of the Development Budget was allocated to MTDS priority areas and the target set for 2009 was to at least maintain this level of alignment.

The achievement of these targets requires Government to eliminate the funding of non-essential expenditure items and switch resources towards its seven priority areas. However, in the 2009 Development Budget only 73.6 percent of GoPNG financing is aligned. This is due to high

spending on non-MTDS priority areas, in particular general government administration and other government services such as housing, office complexes and sewerage.

The effective implementation of the MTDS also requires that new and innovative approaches and strategies are adopted to achieve the targets of the MTDS. The 2009 Development Budget contains several new and innovative strategies to improve the delivery of services under the MTDS. One example of this is the support for Churches to help the Government provide basic education and health services. The Government recognised that Churches have established networks where Government presence is minimal. In October 2008 the Government signed the Church State Partnership, through which the Government and the Churches establish their mutual commitment to work together to meet common challenges and to improve the quality of life for all people of Papua New Guinea. The Social Development Program which is allocated K30 million in the 2009 Development Budget is aimed at translating this commitment into greater access to basic health and education services, which is likely to improve progress towards the national Millennium Development Goals, as stated in the MTDS. Another new approach trialled in the 2009 Development Budget is the civic action program, which will draw on the services of the PNG Defence Force to work on the Baiyer - Madang Road.

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 strategises the timing of spending in the different priority areas and in doing so justifies the spending in one priority area prior to that in another, inclusive of all the EPAs. In this way the allocative efficiency of development expenditure is achieved and net development returns of the expenditure can be realised.

In practice, the Sequencing Principle considers:

- 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 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.
- 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.

Incorporating each of the three sequencing considerations above generates an order for prioritising development expenditure over the seven EPAs. However, in contrast to the 2008 Development Budget, the 2009 Development Budget places the greatest emphasis on spillover effects. Transport infrastructure is considered the catalyst to development, because the delivery of other social services and promoting economic opportunities depends on it. The second priority is income earning opportunities, because the creation of wealth for people in rural areas will lead to rural empowerment. This will enable people to have money for school fees and create opportunities for those resorting to illegal activities, especially youth. On third priority are health services and basic education. Addressing health issues will in turn improve income earning opportunities. Tackling HIV/AIDS now is necessary to prevent large future costs to society and the economy. There is a long lag between expenditure on basic education and reaching a high level of education in the country, justifying education as a priority for current development spending.

6.2.3 Relationship between Government and Donor Expenditure

The Government seeks to ensure that the expenditure of Development Partners is aligned with the Government's priorities. In the past donor expenditure has been fragmented and Government has responded by encouraging Development Partners to imitate its own allocation across the different EPAs. However, the Government is moving towards a policy shift, whereby the Government takes strong leadership and ownership of development expenditure to ensure that donor expenditure is aligned to Government priorities and that development partners harmonise their projects and programs.

In July 2008 the PNG Commitment on Aid Effectiveness was signed between the Government and the heads of all eight development partners channelling resources through the Budget in PNG. This Commitment localised the Paris Declaration Principles to improve aid effectiveness. The principles include GoPNG Ownership; Alignment of development partners' programs and strategies to PNG's priorities; Harmonisation of development partners' strategies and the requirement that development partners use Government systems and processes; Managing for development results; and Mutual Accountability. The Commitment contains specific targets and indicators that must be met by 2012 for each of the above principles. For example these targets specify that by 2012, 85 per cent of development assistance grants must be allocated to the MTDS and other national and sectoral plans and that at least 50 per cent of aid flows must be channelled through GoPNG's financial management systems.

Furthermore, in August 2008 the PNG-Australia Partnership for Development was signed by the Prime Ministers of PNG and Australia in Niue. This Partnership committed PNG and Australia to work together to jointly improve indicators in five agreed priority areas: Health, Basic Education, Transport Infrastructure, Public Sector Capacity and Development Statistics. Specific schedules for these priority areas are currently being drafted. These agreements should allow Government and its major development partner to work together more effectively towards common goals. Further work will be undertaken in 2009 to ensure that aid effectiveness is improved and that development partners allocate their expenditure towards the Government's priorities. Issues that must be tackled include the avoidance of arbitrary funding arrangements and ensuring recurrent funding implications are considered when development partners fund capital expenditure projects.

6.2.4 Medium Term Resource Framework

The Medium Term Resource Framework (MTRF) is an expenditure tool to ensure that the Budget is aligned to the MTDS EPAs, that the sequencing principle is followed and that development partners funds are matched to Government's priorities, and therefore to its own allocation pattern. The MTRF 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:

- *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.

- *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.

When the resource envelope is known in advance, the MTRF and its two outputs can play a valuable role in enhancing the quality of Development Budget appropriations. In 2010 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.

6.3 DEVELOPMENT BUDGET 2009

The Development Budget consists of Donor and Government financing. The contribution of Government to the Development Budget comes in three forms: direct financing, Tax Credit Scheme and loans. Of a total of K2,595.2 million, 62.5% (K 1,620.9 million) comes from Government sources, and 37.5% (K974.3 million) comes from donors in the form of grants. Table 44 summarises the 2009 Development Budget and compares it to the 2008 Development Budget. The figure for grants is lower than in previous years due to the appreciation of the Kina while tax credits have decreased and concessional loans have significantly increased. The Government Direct Financing component of the 2009 Development Budget shows an historic increase from the 2008 Development Budget and also marks the first time since independence that the Government has committed more funds to development than donors have.

Table 44: 2009 Development Budget compared to the 2008 Development Budget (Kina million)

	2008		2009		Difference	Change
GoPNG Direct Financing	526.7	28.1%	1,385.9	53.4%	859.2	163.1%
Tax Credit	73.7	3.9%	40.0	1.5%	-33.7	-45.7%
Concessional Loans	163.0	8.7%	195.0	7.5%	32.0	19.6%
Donor Grants	1,111.2	59.3%	974.3	37.5%	-136.9	-12.3%
Total	1874.6	100.0%	**2,595.2**	**100.0%**	**720.6**	**38.4%**

Source: Department of National Planning and Monitoring

The GoPNG Direct Financing component contains a number of fixed commitments and other Government commitments, which are shown in Table 45 below:

Table 45: Government Commitments (Kina million)

Fixed Commitments:	Loan Counterpart	77.4
	Grant Counterpart	55.1
	Petroleum MOAs	65.5
	Mining MOAs	23.1
	SSGs	35.0
	DSGs	54.5
	Sub-Total Fixed Commitments	**310.6**
Other Commitments:	PDIP	20.0
	DSIP	356.0
	Total Commitments	**686.6**

Source: Department of National Planning and Monitoring

The District Service Improvement Program (DSIP) and Provincial Development Improvement Program (PDIP) substantially increase the Government's commitments compared to previous years. These commitments are in line with the Government's aim to promote rural empowerment and channel resources into the districts and provinces. After accounting for the Government commitments of K686.6 million (K310.6 million fixed commitments, K356 million DSIP and K20 million PDIP), only K699.3 million GoPNG Direct Financing remained to be allocated for both new and ongoing projects. Total Government Commitments account for almost half of Government Direct Financing (49.5%). A significant change in the 2009 Development Budget from the previous Development Budget is the large number of new projects funded relative to ongoing projects. Whereas the 2008 Development Budget allocated 99.1% and 0.9% of GoPNG Direct Financing to ongoing and new projects respectively, the 2009 Development Budget allocates 65.3% and 34.7% of GoPNG Direct Financing to ongoing and new projects respectively.

The 2009 Development Budget allocated funding to a number of major impact projects, shown in Table 46. The DSIP, Provincial Roads Program and the NADP all channel resources into rural areas in line with the aim to promote rural empowerment and transformation. Several high impact projects target the promotion of income earning opportunities, including the Strategic District Markets Program, Development of Business Growth Centres, Fisheries Development Project and NADP.

Table 46: GoPNG direct financed projects/programs over K10 million (KinaMillion)

DSIP	356.0
Provincial Roads Program	110.7
National Agriculture Development Plan (NADP)	80.0
Waigani Office Redevelopment	50.0
National Bridges Maintenance Program	50.0
Marienberg College & Others	30.0
Social Development Program	30.0
Civic Action Program (Baiyer Madang Road)	20.2
National Stadium Construction	20.0
Strategic District Markets Program	20.0
Development of Business Growth Centres	20.0
NADP Credit Facility	20.0
PDIP	20.0

Fisheries Development Project	15.0
Coastal Vessels Program	13.0
Total	**854.9**

Source: Department of National Planning and Monitoring

6.3.1 Expenditure Priority Areas

As indicated in Table 47, K1,488.8 million (57 per cent) of the total Development Budget is directly targeted at the seven MTDS EPAs. Donors fund an estimated 29 per cent outside MTDS EPAs and GoPNG finances an estimated 51 per cent outside MTDS EPAs.

Table 47: 2009 Development Expenditure (Kina Million)

	Total GoPNG	Grants	Total
MTDS Expenditure Priority Areas	794.7	694.1	1,488.8
Other	826.2	280.4	1,106.6
TOTAL	1,620.9	974.3	2,595.2

Source: Department of National Planning and Monitoring

Table 48 shows Government's contribution by MTDS EPA. As can be seen from the table, 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 48: 2009 GoPNG Development Expenditure on MTDS Expenditure Priority Areas (Kina Million)

	Direct Financing	Tax Credit	Loans	Total GoPNG
Primary and Preventive Health	39.6	0.0	0.0	54.6
HIV/AIDS Prevention	5.0	0.0	0.0	5.0
Basic Education	30.8	0.0	0.0	15.8
Dev-Oriented Adult Education	40.0	0.0	0.0	40.0
Transport Rehab and Maintenance	283.3	40.0	131.2	454.5
Income Earning Opportunities	209.8	0.0	5.0	214.8
Law and Justice	10.0	0.0	0.0	10.0
Sub-Total	**618.5**	**40.0**	**136.2**	**794.7**
Other	767.4	0.0	58.8	826.2
TOTAL	**1,385.9**	**40.0**	**195.0**	**1,620.9**

Source: Department of National Planning and Monitoring

As the focus of the expenditure sequencing strategy has changed, the distribution amongst the different EPAs has also changed. Table 49 below shows the level of direct financing to each of the seven EPAs in 2009 relative to funding in 2008.

Table 49: 2009 versus 2008 GoPNG Development Expenditure Direct Financing on MTDS Expenditure Priority Areas (Kina Million)

	2008 GoPNG Direct Financing	2009 GoPNG Direct Financing	Change	Change (%)
Primary and Preventive Health	34.8	39.6	4.8	13.8%
HIV/AIDS Prevention	17.0	5.0	-12.0	-70.6%
Basic Education	10.5	30.8	20.3	193.3%
Dev-Oriented Adult Education	3.3	40.0	36.7	1112.1%
Transport Rehab and Maintenance	148.0	283.3	135.3	91.4%
Income Earning Opportunities	38.4	209.8	171.4	446.4%
Law and Justice	31.0	10.0	-21.0	-67.7%
Sub-Total	**283.0**	**618.5**	335.5	118.5%
Other	243.7	767.4	523.7	214.9%
TOTAL	**526.7**	**1,385.9**	859.2	163.1%

Source: Department of National Planning and Monitoring

The amount of funding allocated outside the EPAs has increased in 2009 compared to 2008. In particular, in 2009 the funding on Other Government Services and General Government Administration is high. Within the category of government administration, many database projects are funded and several projects that support information required to plan for the MTDS priority areas. Other administrative costs involve institutional strengthening and capacity building. Other Government Services have escalated due to funding of housing developments in the Districts, and large projects such as sewerage projects and office complexes.

Other non-MTDS EPA expenditure is for constitutional grants (District Support Grants) and development grants (Special Support Grants (SSGs), Memorandum of Agreements (MoAs)[1] and the Bougainville Peace Agreement). It is estimated that the majority of both constitutional and development grants are ultimately expended on MTDS aligned projects and initiatives. Appropriations for development grants are lower in 2009 due to low petroleum MOAs because the short term focus of the Government is to fund the ongoing and outstanding Expenditure Implementation Committee (EIC) approved projects and because the EIC guidelines are not yet in place.

[1] MoAs are agreements between the National and Provincial Government and landowners specifying a list of projects, which the Government is obligated to fund as part of its commitment. Section 178 of the Oil and Gas Act establishes the Expenditure Implementation Committee, which is responsible for approving MoA project submissions for funding under the MoA appropriation.

Table 50: 2009 GoPNG Development Expenditure Outside of MTDS Expenditure Priority Areas (Kina Million)

	Direct Financing	Tax Credit	Loans	Total GoPNG
Governance Reform	15.4	0.0	0.0	15.4
General Government Administration	91.4	0.0	28.7	120.1
Aid Administration	0.0	0.0	0.0	0.0
Constitutional Grants	54.5	0.0	0.0	54.5
Development Grants	514.6	0.0	0.0	514.6
Other Government Services	91.5	0.0	30.1	121.6
TOTAL	**767.4**	**0.0**	**58.8**	**826.2**

Source: Department of National Planning and Monitoring

In all, 73.6% of GoPNG expenditure in the 2009 Development Budget is estimated as being MTDS aligned. This compares to GoPNG's target of 82.7%. Government direct financing outside of the EPAs is high due to Government development grants such as District Service Improvement Program (DSIP - K356 million) and the Provincial Development Improvement Program (PDIP – K20 million).

The ratio of GoPNG to donor expenditure has changed from 2008 to 2009. In 2009 the Government is the lead financier of three EPAs: Transport Maintenance and Rehabilitation, Adult Education and Income Earning Opportunities. Donors significantly dominate in the EPAs of HIV/AIDS, Law and Justice and Basic Education. Compared to 2008, 2009 development expenditure shows closer matching for health and Basic Education, due to an overall higher GoPNG component in the 2009 Development Budget and the Government taking an even stronger lead in Transport Rehabilitation and Maintenance.

Table 51: 2009 GoPNG Development Expenditure Versus Donor Expenditure (Kina Million)

	2009 GoPNG Development	2009 Donor Grants	2008 Ratio	2009 Ratio
Primary and Preventive Health	39.6	106.3	1:3	1:3
HIV/AIDS Prevention	5.0	71.2	1:5	1:14
Basic Education	30.8	144.8	1:16	1:5
Dev-Oriented Adult Education	40.0	5.8	∞	7:1
Transport Rehab and Maintenance	454.5	178.2	2:1	3:1
Income Earning Opportunities	214.8	91.9	1:3	2:1
Law and Justice	10.0	96.0	1:3	1:7
TOTAL/AVERAGE	**794.7**	**694.1**	**1:2**	**1:1**

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 52: 2009 GoPNG Total Expenditure Versus Donor Expenditure (Kina Million)

	2009 GoPNG Recurrent & Development	2009 Donor Grants	2008 Ratio	2009 Ratio
Primary and Preventive Health	585.4	106.3	5:1	5:1
HIV/AIDS Prevention	10.9	71.2	1:4	1:7
Basic Education	680.6	144.8	4:1	5:1
Dev-Oriented Adult Education	55.8	5.8	-	10:1
Transport Rehab and Maintenance	576.1	178.2	3:1	3:1
Income Earning Opportunities	361.7	91.9	3:1	4:1
Law and Justice	418.5	96.0	5:1	4:1
TOTAL/AVERAGE	**2,689.1**	**694.1**	**4:1**	**4:1**

Source: Department of National Planning and Monitoring

6.4 MONITORING DEVELOPMENT

Since 2007, the Government has come up with various initiatives to improve the monitoring of development progress:

- The MTDS Performance Management Framework (PMF) monitors progress in the MTDS priority areas;
- PNGInfo will contain data on the progress towards the Millennium Development Goals (MDGs); and
- The Results Based Monitoring System will monitor the projects and programs under the Public Investment Program (PIP).

6.4.1 MTDS Performance Management Framework

The MTDS Performance Management Framework (PMF) is a tool intended to track the country's rate of development in 13 MTDS PMF sectors. The two main outputs of the MTDS PMF are:

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

The first edition of the MTDS PMF Pocketbook was published in 2007 and has been made available to a wide audience, including Government Agencies, Development Partners and civil society.

The scorecard shown on the right provides a sector assessment for each of

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

the 13 MTDS sectors. There are two aggregated grades for each sector – the trend (assessment over the period 2001 to present) and the latest performance (assessment of latest available data). 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 2007 PMF showed a slight improvement in the aggregate latest performance of sectors and encouragingly, the 2008 PMF again shows an improvement of the latest indicators. However, within this aggregate score, some areas have been in decline (e.g. Law and Justice and Governance) and some have halted their progress (Public Sector Reform). However, others have been consistently improving (e.g. Transport, Macroeconomy). It is important to note which areas within the sector have fared poorly, in order to target those specific areas.

Improving the indicators and the quality of data is crucial to improving the assessment that the PMF provides. Although the PMF does not claim to provide a robust analysis of MTDS implementation, the data and analysis it contains has been commended by various stakeholders and provides an accessible avenue to gain an overview of progress in the MTDS priority areas.

6.4.2 PNGInfo

A recurring problem in PNG has been the provision of the required secondary data for analysis and for monitoring frameworks. There are weaknesses in reporting, compiling and sharing data. To address these problems and improve on monitoring development, the Government has adopted the DevInfo (Development Information) System. DevInfo is a globally used database management system for the Millennium Development Goals (MDGs), but the data it stores can be used for purposes other than monitoring the MDGs. In 2008, the Government commenced work on PNGInfo, a customized version of DevInfo, for which collaboration among the relevant departments has commenced. PNGInfo will contain secondary data from reliable sources and publications on the MDGs and other development indicators for access by all. In the future, it is envisaged that PNGInfo could capture data at District levels too.

6.4.3 Results-Based Monitoring System

In 2009 the Government will introduce a *Results-Based Monitoring System* to make the Public Investment Program more outcome-oriented. It will also serve to improve development reporting and accountability as well as improve targeting of development resources to areas where PNG's development indicators are weakest.

6.5 FUTURE DEVELOPMENT BUDGETS AND STRATEGIES

It is a tremendous challenge to ensure that resources are used in line with MTDS priority areas, and crucially, that these recourses are utilized productively to impact development outcomes. Allocation of resources to MTDS priority areas – and even adherence to the Sequencing Principle to improve allocative efficiency is necessary, but not sufficient, to ensure that development objectives outlined in development strategies are met. The quality of the selection of projects or programs and service delivery mechanisms are crucial in ensuring that development indicators improve.

Monitoring the impact of the Development Budget is a complex task, due to the various funding sources that all contribute towards development outcomes. It is currently not

possible to determine how far the Development Budgets since 2005 have impacted development indicators. Problems in data monitoring and coordination complicate this task. However, the MTDS Review, which will be published in 2009, should provide some indications of the effectiveness of the MTDS implementation and guidance for the formulation of the next MTDS (2010-2015).

Despite the complexities in evaluating the MTDS, it is evident that minimal progress has been made in the priority areas of the MTDS since its implementation. This lack of progress comes despite significant funding of the Development Budget from generous foreign aid and recent windfall Government revenues. Furthermore recent data shows the lack of progress of social indicators and even a worsening of some indicators over the past decade. In addition, even where some development progress has been made at the national level, provincial development indicators show large disparities that have not been addressed. This calls for drastic reforms in the way the Development Budget is being implemented to attain development results.

The new reforms, which will be aimed at reinvigorating the systems, processes, and institutions to effectively implement future Development budgets will include:

- Implementing a Long Term Development Strategy;
- Strengthening Institutional Capacity to Deliver Services; and
- Improving the Credibility and Rationale of Development Planning.

6.5.1 Long Term Development Strategy

A *Long Term Development Strategy* (LTDS) is at present in draft form and will be finalized in 2009 to address the above concerns. The LTDS will then be formulated by the mandated Government Agency. It will provide the overarching policy oversight and guidance for all development agendas and sectoral strategies. Starting in 2010, it will encompass successive five-year Medium Term Development Plans. The LTDS will be guided by a Public Investment Strategy and include a national plan for infrastructure development and for other important development programs and initiatives (e.g. the proposed private sector export growth strategy focusing on Small Medium Enterprises; HIV/AIDS and population programs). Other national development policies that are currently being undertaken will assist in the implementation of the LTDS (e.g. the proposed Public Private Partnership Policy and commitments to enhance development cooperation such as the *PNG Commitment on Aid Effectiveness* and the *Accra Agenda for Action*).

6.5.2 Strengthening Institutional Capacity to Deliver Services

To effectively implement the LTDS, legislative and institutional reforms will be established. These reforms will include a National Planning Act, to establish an optimal, feasible and consistent planning system that integrates bottom up and top down planning processses. This will standardise policy process and improve serivce delivery at the lower levels. Furthermore, the Government is looking at putting in place an Aid Information Management System (AIMS) in 2009 to better track donor financing. These inititaives will enable the Government's planning systems to become more output oriented.

6.5.3 Improving the Credibility and Rationale of Development Planning

The challenge to improve the country's development and ensure that essential services are available to the whole population, even those living in remote areas, is a formidable task. To be effective and credibly succeed in this task the Government must ensure that:

- Monitoring and evaluation on development progress is strong and guides development planning;
- Maintenance requirements of new infrastructure will be funded, rather than infrastructure being neglected and rehabilitated at greater cost or new infrastructure funded, which cannot be maintained;
- Development targets and goals are realistic given projections of Government revenue and costings;
- Geographical distribution of benefits is considered based on the needs of the population and linkages in the economy; and
- Capacity of the public service is improved.

To address these critical issues, the proposed LTDS will seek to:

- Provide increased resources for data collection, coordination and analysis and ensure agencies and departments report their data;
- Better identify revenue sources and recurrent and development expenditure through a Public Investment Strategy and improve maintenance of assets through an Asset Maintenance Policy;
- Ensure that there is a rational economic basis for all targets and goals in each sector and establish the cost of providing services;
- Consider equity in the distribution of resources and linkages in the economy by undertaking a spatial planning approach; and
- Focus on human resource management in all sectors.

provinces. This fragmentation has resulted in deteriorating health service indicators since 1995. The Annual Health Sector Review for 2007 highlighted that many health indicators have worsened while only 7 out of 20 indicated minor improvements. One marked improvement is the declines in incidences and deaths due to malaria. However, the Demographic Health Survey (2006) results on maternal mortality rates are of great concern. In addition, the MTDS Performance Management Framework shows a decreasing trend in the proportion of deliveries that are supervised and the proportion of health centres that receive at least one medical officer visit a year. Furthermore, all regions have reported problems with accessing provincial health services, lack of drug supplies, lack of funds for health service delivery and closed aid posts in isolated location. There is also the need to review and upgrade staffing numbers, levels and mix.

Addressing most of these issues requires a whole of government approach. This is especially in the areas of health facility infrastructure development, maintenance and rehabilitation of medical equipments; improving human resources for rural health services; ensuring funds from both recurrent and Health Services Improvement Program (HSIP) are available at the facilities and district levels for program implementation and service delivery to take place when and where they are needed.

There are a number of underlying issues that contribute to the lack of access to medical services, which lead to poor health indicators. The HSIP is a mechanism to pool funds in the health sector and uses existing Government systems and processes to disburse and account for these funds. However, there are issues pertaining to the use of these funds. This is mainly due to stringent procedures leading to very low draw down of HSIP funds. In particular, capacity issues relating to financial understanding hinder the access of appropriated funds. This is especially the case for the District level where the legal requirements and procedures for requests and acquittal for HSIP funds are too complicated for Districts to fulfil. Another obstacle is the coordination between Provincial administration and District and Provincial Health Offices, where funds are not made available to health facilities to implement programs. There is a need for Treasuries to be established at the district level so that funds can be made available at the district for the facilities use where and when needed.

Major problems in the health sector are also related to the Organic Law on Provincial Government, which mandates Provincial Governments with responsibility over the delivery of rural health services in the province. The National Department of Health has no role in provincial health services delivery and can only support by setting policies, standards and monitoring the health system. In addition the Department procure and transport medicines to the provincial head quarters in order for the provincial governments to transport them to the health facilities in the districts. Many of the issues which affect service delivery are also the result of progress in other sectors, for example, the poor transportations, infrastructure, lack of a continuous supply of water and electricity, lack of telecommunications infrastructure, poor schooling and law and order problems.

The National Health Board has highlighted key issues that must be supported in 2009. These include revising current institutional arrangements for streamlining of public hospitals and rural health services; ensuring that performance is monitored and evaluated; ensuring that an effective recruitment and retention strategy is implemented; encouraging staff to work in rural areas; improving education and training in the health sector; improve human resource management; and making funds available at the district and health facilities level for services and program implementation.

Furthermore, in July 2008 the National Department of Health's Corporate Plan 2009-2013 was launched. The Corporate plan prescribes the roles and corporate leadership of the

Health Department in making sure that the appropriate plans are in place to address the issues at hand. The Corporate Plan directs the way forward and identifies four major areas for action. These include the development a Health Workforce Plan, Information and Communication Plan, Capital Infrastructure Development and Replacement Plan and a evidence based Financial Plan for Service Delivery. The Department of Health is now in the process of developing the new twenty year National Health Plan for the period 2011 – 2030.

The figures in Table 53 show the level of funding from the Government and from Development Partners since 2003. The figures show that the 2009 Development Budget, consistent with the trend since 2003, has increased Government spending in this area. This increase shows Government recognition that increased funding is required to address the immediate challenges in the health sector.

Table 53: Development Appropriations for Primary and Preventative Health 2003-2009 (Kina Million)

	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	43.6
2007	12.5	0.0	0.0	78.3	90.8
2008	17.0	0.0	0.0	84.3	101.3
2009	39.6	0.0	0.0	109.8	149.4

Source: Department of National Planning and Monitoring

Table 54 shows the major programs and projects being funded in the 2009 Development Budget. A new major program funded by the Government is the Social Development Program, which will tackle the issue of rural health service delivery by working in partnership with the Churches to improve access to health services.

Table 54: 2009 Development Expenditure on Primary and Preventative Health (Kina Million)

	GoPNG	Donor	Total
Capacity Building Service Centre	0.0	31.6	31.6
Health Sector Resourcing Framework	0.0	21.2	21.2
Social Development Program - Health	15.0	0.0	15.0
Health Sector Improvement Program (HSIP)	5.0	7.1	12.1
District Town and Water Supply	0.0	9.5	9.5
Purchase of Medical Equipment	6.0	0.0	6.0
Other	13.6	40.4	54.0
Total	**39.6**	**109.8**	**149.4**

Source: Department of National Planning and Monitoring

7.2.2 HIV/AIDS Prevention

HIV/AIDS is a development issue that has the potential to significantly undermine social and economic progress of PNG. After the HIV prevalence rate for anti-natal care patients at the Port Moresby General Hospital exceeded one percent in 2004, PNG became the fourth

country in the Asia-Pacific region to declare a generalized epidemic. The UNGASS 2008 Country Progress Report estimated that by December 2007, the national prevalence rate was 1.61 percent with an estimated 59,537 people infected. However, the report highlights a worrying trend of strong increases in the prevalence rate in rural areas (1.65 percent compared to 1.38 percent in urban areas). The increasing trend of the HIV epidemic becoming more rural is of particular concern, not just because the majority of the population live in rural areas, but because reversing the trend is more difficult in rural areas. This is due to low literacy levels and limited access to basic health, education and transport services in rural areas.

In response to the epidemic, the Government has put key polices to guide the national response to HIV/ AIDS. In addition to including HIV/AIDS as one of the seven expenditure priorities of the MTDS, the Government endorsed the National HIV and AIDS Strategic Plan (2006-2011) in December 2005, which provides the broad framework for all agencies and organizations to respond to the epidemic within their own capacity and guides annual operational plans. The strategic framework focuses on seven main areas for intervention: Treatment, counselling, care & support; Education and prevention; Epidemiology and surveillance; Social and behavioural change Research, leadership, partnership and coordination; Family and community support; and Monitoring and evaluation. Other policy responses include the National Gender policy and Plan on HIV and AIDS 2006-2010 which has been developed to guide efforts to integrate gender issues into the response, and integration of HIV/AIDS into sector specific plans, such as the National Health Plan and the HIV and AIDS Policy for the National Education System of PNG.

The National AIDS Council Secretariat (NACS) plays a coordinating and facilitating role. It has outsourced function to the Department of Health and NGOs, including care and counseling, education and training, advocacy and prevention through information, education and communication (IEC), peer education, monitoring and surveillance. In 2008 NACS have been highlighting that the national response to HIV/AIDS is not a health issue, nor solely the responsibility of the Government Two important organizations assisting in mainstreaming HIV/AIDS prevention into society are the PNG Business Coalition against HIV and AIDS (BAHA) and the PNG Alliance of Civil Society Organizations (PACSO).

In 2008 a new National Leadership Strategy was implemented to progress efforts to mobilise, build capacity and sustain leadership at all levels to ensure an effective response. In addition, the support in provision of treatment continued in 2008, with the number of anti-retroviral treatment (ART) sites having increased from two in 2004 to 38 in December 2007, which must continue in 2009 given the higher rates of HIV/AIDS. Furthermore monitoring and evaluation has improved significantly over the past few years to identify the groups among the population that are at highest risk. In light of the concern that young women are becoming more vulnerable to the virus, due to engagement in profitable sexual activities, the effort to raise awareness must significantly be scaled up in 2009 to reverse this trend.

Government funding will continue to support the implementation of the national response to HIV/AIDS. In 2008 the program established Provincial AIDS Committees (PACs) in all provinces to work with respective health authorities and NGOs. In 2009 the Government's HIV/AIDS program will include allocation of grants to Provincial AIDS Committees, finance NACS and PACs multi-sectoral coordination activities and also provide grants to NGOs, FBOs and CBOs to implement activities under the NSP. The AusAID funded Sanap Wantaim Program will support the health sector response to HIV/AIDS and fund treatment for HIV positive people and service delivery of management services and Sexually Transmitted Disease Prevention.

Table 55: 2009 Development Expenditure on HIV/AIDS Prevention (Kina Million)

	GoPNG	Donor	Total
Sanap Wantaim- PNG Australia HIV and AIDS Program	0.0	42.4	42.4
Health Program response to HIV Sector	0.0	18.1	18.1
National Strategic Plan on HIV/AIDS - Implementation Program	5.0	0.0	5.0
HIV/AIDS Prevention and Control in Rural Dev. Enclaves	0.0	5.2	5.2
Other	0.0	5.5	5.5
Total	**5.0**	**71.2**	**76.2**

Source: Department of National Planning and Monitoring

Table 55 shows that HIV/AIDS is one area where financial assistance has been dominated by Development Partners.

Table 56: Development Appropriations for HIV/AIDS 2003-2009 (Kina Million)

	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	43.6
2007	12.5	0.0	0.0	78.3	90.8
2008	17.0	0.0	0.0	84.3	101.3
2009	5.0	0.0	0.0	71.2	76.2

Source: Department of National Planning and Monitoring

7.2.3 Basic Education

The Government, through the Department of Education, is committed to achieving Universal Primary Education (UPE). The National Education Plan (NEP) 2005–2014 aims to achieve Universal Primary Education (UPE) by 2015. The overall objectives of the NEP 2005-2014 are consistent with the MTDS and its National Millennium Development Goals. UPE remains the central pillar which guides education reforms in Papua New Guinea. Under this objective, the Government aims to provide the opportunity for all children to complete nine years of basic education.

Gross enrollment at primary-level was 79.9 percent in 2007 – up from 60.9 percent in 2005, which shows significant progress towards the target of universal enrollment in primary school. However, these aggregate figures mask large disparities between provinces. The challenge for the education sector is to address enrollment in provinces with particularly low rates. Despite improvements in gross enrollment rates, retention rates remain low, which is often due to affordability, but also lack of infrastructure and poor quality teaching.

Higher basic education enrollment rates have led to a higher demand in the enrollment at further levels of education. In particular there is a growing pressure for places at secondary school and this increase in demand for secondary places must be planned for in the following years. High population growth rates put additional pressure on the limited

resources in the education sector. The increase in enrollment has also led to higher demand for teachers and facilities, and thus higher funding requirements. There has been a moderate increase in the number of primary teachers attaining their diploma. However, placement of teachers in the rural districts and communities where they are most needed still remains critical to improving accessibility to education.

The quality of primary education and retention rates are also greatly affected by teacher attendance and their level of performance, which can be poor in rural areas, where basic amenities and performance monitoring are lacking. Of concern is the apparent overall lack of improvement in the quality of education. Indicators from the MTDS Performance Management Framework (PMF) show average class sizes have been increasing in recent years and the number of visits of school inspector has decreasing. Performance monitoring plays a vital role in improving the quality of schooling and measures need to be taken to improve this and other factors relating to the quality of education.

In responding to these challenges, the Government has introduced a number of new projects, including:

- Curriculum Teacher/Student Resource Materials Development;
- Production and delivery of reform examination and assessment materials and curriculum standards and monitoring;
- Universal Basic Education Plan to be completed in 2008 and commence full implementation in 2009 under the recurrent expenditure; and
- Education Information and Communication Technology.

A major innovation in 2009 will be the introduction of the Education Information Communication Technology, which will enable more accurate and complete data collection, compilation and analysis to inform sector planning and policies in the future, especially in tracking the progress towards UPE. This initiative will also support the implementation of One Laptop Per Child (OLPC) program in primary schools nationwide, which is likely to greatly to improve the quality of education in schools. This initiative will also build capacity within the Department of Education, Provincial and District education staff and for teachers.

The Department of Education has agreed to adopt a Sector Wide Approach (SWAp), referred to as the Education Sector Improvement Program (ESIP), in which all significant funding will support a single sector policy and expenditure framework under government leadership. The aim of moving to a SWAp is to improve education service delivery in PNG through better coordination of all investments against an agreed and prioritized plan. The development and implementation of the new approach is evolving and there is strong support from Development Partners and provincial stakeholders. However, the development of the ESIP is progressing slowly, as the problems encountered in the health SWAp in PNG and other Pacific countries' SWAp experiences are considered.

The total appropriations to Basic Education between 2003 and 2009 are shown in Table 57. Government's share of funding increased significantly between 2003 and 2007, including the large injection of funds in the 2007 Supplementary Budget for the Rehabilitation of Education Sector Infrastructure (RESI) program, which is aimed at not only Primary Schools, but also National High Schools, Provincial Secondary Schools, Vocational and Technical Schools. However, in 2008 and 2009 there has been a decline in Government financing to the sector within the Development Budget. The reasons for this are the increased funding through the RESI program, but also the lack of institutional capacity within the Department of Education to implement programs and projects resulting in under utilization of development expenditure. The Government has allocated funding towards the Social

Department Program (SDP), which will move resources to helping Church-run educational facilities in order to improve basic education services in rural areas.

Table 57: Development Appropriations for Basic Education 2003-2009 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	2.7	0.0	0.0	69.0	71.7
2004	5.9	0.0	0.0	141.5	147.4
2005	5.7	0.0	0.0	170.4	176.1
2006	14.4	0.0	0.0	151.5	165.9
2007	26.9	0.0	0.0	74.4	101.3
2008	10.5	0.0	0.0	163.1	173.6
2009	30.8	0.0	0.0	144.8	175.6

Source: Department of National Planning and Monitoring

Table 58: 2009 Development Expenditure on Basic Education (Kina Million)

	GoPNG	Donor	Total
Education Training and Human Resource Development Program	1.0	70.0	71.0
Education Capacity Building	0.5	43.5	44.0
Social Development Program - Education	15.0	0.0	15.0
Basic Education Development Project (BEDP)	1.0	21.8	22.8
Curriculum Teachers/Students Resource Materials Dev	5.0	0.0	5.0
Other	8.3	9.4	17.7
Total	**30.8**	**144.8**	**175.6**

Source: Department of National Planning and Monitoring

7.2.4 Development Oriented Adult Education

Being functionally literate and attaining entrepreneurial and vocational skills that allow productive participation in the economy is essential for people to be able to create an income for themselves and to move people out of poverty and towards greater self-reliance. In an increasingly globalised and technologically advanced world, being able to read and write well and acquire skills and knowledge in information technology is of particular importance. The MTDS, has recognised the need to elevate Development Oriented Adult Education to an expenditure priority status to address the needs of the 50 per cent of adults who are illiterate. In addition to improving economic opportunities, being literate also improves the chances of a person taking preventative measures against HIV/AIDS and other debilitating but preventable diseases such as tuberculosis and malaria.

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 agency of Government should coordinate the sector's response. Furthermore there is no clear way that assesses in which areas (economic or geographical) adult education should be focused. These issues have resulted in funding to the sector being markedly lower than for other expenditure priority areas. Over the past few years development expenditure for this priority area has been of the order of 1 percent. As can be seen from the figures in Table 59, there has been

an overall decreasing trend of funding towards this area, despite a slight increase in Government direct financing.

Table 59: Development Appropriations for Development Oriented Adult Education 2003-2009 (Kina Million)

	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	22.2
2005	1.0	0.0	6.1	3.7	10.8
2006	1.3	0.0	6.4	6.4	14.1
2007	3.5	0.0	2.9	9.0	15.4
2008	3.3	0.0	0.4	0.0	3.7
2009	40	0.0	0.0	14.1	54.1

Source: Department of National Planning and Monitoring

The lack of a clearly defined policy and a coordinating agency means that response to this sector is ad hoc with little or no impact. The Department of Education is targeting technical and vocational education as a means of addressing school leavers who are forced out of the education system at year 8 or 10 and thus often become unemployed or underemployed. In addition, the Department of Education runs an adult literacy program that is geared towards enabling the more than 50 percent of adults of the population who are illiterate to become functionally literate and thus be given the opportunity to participate in economic development. The need for alternative education pathways and a demand driven education system is now apparent. Some other major initiatives targeting this priority area are:

- Department of Commerce and Industry funds the Women Textile Training Centre and the Start/Improve Your Business program;
- The Consultative Implementation and Monitoring Council (CIMC) runs an Informal Sector Training program.
- Department of Community Development runs special programs for target groups such as youth and women; and
- The Law and Justice Sector Program conducts training for inmates in PNG prisons as a means of empowering them with skills and knowledge that will make them meaningful contributors to society when they leave prison.

Recognising the capacity problems within the public service, the Government is now seeking to build partnerships with civil society organizations like churches, NGOs and the private sector to deliver services in this sector. This policy shift is consistent with one of the underlying principles of the MTDS, which is to forge strategic alliances.

The major programs in the 2009 Development Budget specific to this EPA are shown in Table 60. The Government has recognised the importance of funding vocational training centres and as such these projects have received priority funding in the 2009 Development Budget.

Table 60: 2009 Development Expenditure on Development Oriented Adult Education (Kina Million)

	GoPNG	Donor	Total
PNG-Australia Targeted Training Facility	0.0	8.3	8.3
Human Resource Training	0.0	3.0	3.0
Vocational Training Support	2.0	0.0	2.0
Young Leaders and Group Training	0.0	1.9	1.9
Provincial Vocational Centre Capacity Building	1.0	0.0	1.0
District Community Learning and Development Focal Points	2.0	0.0	2.0
Employment Orientated Skills Development Project	1.0	0.0	1.0
Other	34.0	0.9	34.9
Total	**40.0**	**14.1**	**54.1**

Source: Department of National Planning and Monitoring

7.2.5 Transport Rehabilitation and Maintenance

Transport infrastructure underpins the social and economic development of the country. Properly maintained infrastructure enables access to a range of services including law and order, education and health services. It also allows movement of people and goods between markets thereby enabling economic activity to take place.

All three modes of transport (land, air, and water), while major Government assets, have been subject to a lack of maintenance and rehabilitation. Reasons for this include lack of adequate funding, poor prioritisation, poor implementation of responsibilities between the National and Provincial governments and allowing a 'build-deteriorate' cycle rather than a 'build-maintain' cycle.

The Government has identified the importance of maintaining and rehabilitating transport infrastructure in the MTDS and annual budgetary allocations have reflected the priority status of transport infrastructure. As in previous Budgets, the Government, through the Development Budget (including direct financing, tax credits and loans) and Supplementary Budgets, has increased funding towards this priority area. The Government remains the 'lead financier' in the sector. In addition, AusAID funding is expected to increase in this area, after the signing of the PNG-Australia Partnership for Development, which includes '*key national roads, ports and airports providing access to market and services*' as the first priority outcome.

Table 61: Development Appropriations for Transport Maintenance and Rehabilitation 2003-2009 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	93.5	0.0	137.5	147.6	378.6
2004	89.4	0.0	115.0	240.8	445.2
2005	105.6	69.2	137.5	211.5	523.8
2006	193.1	71.1	100.5	173.7	538.4
2007	159.8	85.4	132.3	185.9	563.4
2008	148.0	73.7	116.4	220.8	558.9
2009	283.3	40.0	131.2	197.9	652.4

Source: Department of National Planning and Monitoring

Efforts to maintain and rehabilitate transport infrastructure to good and usable conditions is continuing, as evidenced by the annual assessment of the national rod network under the Road Asset Management System (RAMS), with each 10km stretch of road classified as either good, fair or poor. The proportion of national roads in good condition has been improving each year from 2003 at 2007. The condition of the 16 priority roads nominated in the National Transport Development Plan (NTDP) 2006 – 2010 have also shown a significant improvement in recent years, from 26.7 percent of the priority roads being in 'good' condition in 2005 to 37.3 percent in 2007. Road Asset Management System (RAMS), with each 10km stretch of road classified as either 'good', 'fair' or 'poor'. As funding is targeted towards the priorities stipulated in the NTDP, this percentage is expected to increase further, albeit with a lag after the appropriations due to letting of contracts and completion of works.

The Civil Aviation Authority has succeeded in having four of the 22 regional airports fully certified and it is expected that up to four additional airports will be certified by the end of 2008. PNG Ports Corporation has increased its maintenance activities targeting the existing Lae Port, and planning major upgrades to the Wewak Wharf. In addition, loan financing of around US$100 million from the Asian Development Bank has been secured to finance the extension of Lae Port, which caters for over 80% of exports, however, the project cannot yet commence due to complications in the implementation of the project.

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 to implement projects. There are a range of reasons including lack of qualified engineers and technical staff - in both the private and public sectors; private contractors having cash flow difficulties; delays in the procurement and approval processes of Government; competition from the mining sector for resources and years of neglecting to train engineers and technical staff. Sector agencies, with the support of donors, are discussing a range of strategies to address these capacity constraints.

In addition, the prioritisation of rehabilitation and maintenance works still needs to be improved. While Government is increasing the amounts available to the sector it is spread amongst the priorities of the NTDP 2006 – 2010 and non-priority areas. Such an approach is reducing the impact of the additional funding by spreading resources too thinly. Both donors and Government agencies must be committed to ensuring that the 16 priority roads, which have been identified as having significant economic and social importance, are prioritised. The Government's Transport Sector Coordination Monitoring and Implementation Committee (TSCMIC) can take the lead in co-ordinating the agencies and donors in this sector.

The major items in the 2009 Development Budget for the transport maintenance and rehabilitation priority area are shown in Table 62. In line with the aim to empower the rural economy, a major new program for the transport sector is the Provincial Roads Program. Loans for transport infrastructure have also substantially increased in 2009 due to the substantial estimated loan drawdown of the Highlands Region Roads Improvement Investment Program (HRRIIP).

Table 62: 2009 Development Appropriations on Transport Maintenance and Rehabilitation (Kina Million)

	GoPNG	Tax Credit	Loans	Donor	Total
Provincial Roads Program	110.7	0.0	0.0	0.0	110.7
ADB Road Maintenance & Upgrading Project (5 Highlands Provinces)	35.0	0.0	50.5	0.0	85.5
PNG Transport Sector Support Program (TSSP)	2.0	0.0	0.0	80.7	82.7
Performance Grant	0.0	0.0	0.0	65.3	65.3
World Bank Road Maintenance Project	14.0	0.0	36.3	0.0	50.3
Bridge Maintenance Program	50.0	0.0	0.0	0.0	50.0
Tax Credits & TCS Administration	0.0	40.0	0.0	0.0	40.0
Highlands Region Roads Improvement Investment Program	8.0	0.0	30.0	0.0	38.0
Usino Junction-Yamagi Road Project (Ramu)	0.0	0.0	0.0	20.0	20.0
Key Roads For Growth (KRFG) - Highlands Highway Maintenance (AusAID)	1.0	0.0	0.0	17.8	18.8
ADB Community Water Transport	2.4	0.0	8.6	0.0	11.0
Other	60.2	0.0	5.8	14.0	80.0
Total	**283.3**	**40.0**	**131.2**	**197.9**	**652.4**

Source: Department of National Planning and Monitoring

7.2.6 Promotion of Income Earning Opportunities

In PNG there are limited options available for individuals who wish to participate in the economy and earn themselves an income. This has resulted in an increase in law and order problems, prostitution and poverty. In addition labour productivity in PNG is often low, so those who are participating in the economy tend to earn low incomes. Increasing incomes of poorer and average Papua New Guineans is crucial to enabling the majority of the population to afford basic goods and services and to improve health and education, which would improve PNG's socio-economic indicators, some of which are the worst in the Pacific region.

In response to this, the Government has included Promotion of Income Earning Opportunities one of its seven MTDS expenditure priority areas. To increase income earning opportunities the MTDS states that the government should focus on facilitating development-oriented adult education, expanding informal learning opportunities in partnerships with civil society organizations and establishing micro-credit and micro-savings institutions. These areas have been specifically addressed in the Development Budget, but also included in agricultural projects that have microfinance and skill-building components.

Recent data show improvement in key indicators relating to income earning opportunities. Firstly, the growth of microfinance and credit are encouraging with both the microfinance institutions and the National Development Bank reporting increased lending since 2005. Plans to establish branches of these institutions nationwide would create competitiveness, leading to improved services and thus increasing opportunities for both the private sector and ordinary Papua New Guineans to participate in economic activities. Secondly, formal employment in the non-mining sector has been increasing since 2002 with the formal employment index in this sector increasing from 103.8 in 2002 to 131.1 in 2007. 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 focused largely on roads and buildings.

While the increasing trend of formal sector employment should be encouraged in order to promote sustained benefits, the majority of Papua New Guineas depend on income from the informal, rather than from the formal sector. Therefore the finalization of a National Informal Sector Policy, which is currently being drafted, should encourage better coordination and development of this sector to provide more profitable income earning opportunities for the unemployed and provide alternative options for those engaged in illegal activities or dependent on others for survival.

In addition to proactive participation by Government to improve opportunities in the informal sector and access to credit, it is critical that the Government provides a climate that attracts investment. To do this, the Government must reduce impediments to investment and businesses, show consistency and discipline in Government spending and sound macroeconomic management. These factors will encourage new investments, re-investment and business diversification, which lead to job creation and increased incomes. Recent changes to PNG's taxes are intended to promote business and employment, including 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. However, the Government needs to improve its efforts in this area in order to reverse the deterioration in rankings in the World Bank's *Doing Business Survey* between 2005 and 2007.

A major obstacle to encouraging business is the poor infrastructure in PNG, in particular transport and electricity. Government's investment in transport infrastructure will have a direct impact on the operating costs and thus the profitability of business in PNG. However, the quality of other utilities such as electricity remains poor, forcing many businesses to purchase diesel generators, which are costly to purchase, maintain and operate. Introduction of competition in the mobile communications industry has significantly reduced prices and led to increased service coverage and provides an example of the benefits that can accrue to the economy when competition is introduced. Wherever this proves to be appropriate, the Government should promote competition in service delivery.

Table 63 shows that the total amount of funds going towards this priority area has been increasing in recent years with a large increase in Government direct financing and loans in the 2009 Development Budget. Many of PNG's major Development Partners focus their strategies on poverty reduction and rural development and as such support for income earning opportunities in the form of grants is continuing.

Table 63: Development Appropriations for Income Earning Opportunities 2003 2009 (Kina Million)

	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	166.9
2006	49.2	0.0	10.8	85.9	145.9
2007	51.5	0.0	8.2	67.9	127.6
2008	38.4	0.0	17.0	141.4	196.8
2009	209.8	0.0	5.0	57.4	272.1

Source: Department of National Planning and Monitoring

Table 64 shows funding allocations in the 2009 Development Budget. Support in 2009 is focused in the traditional sectors such as agriculture and mining, but areas such as tourism and projects that promote entrepreneurialism, business skills and Small and Medium Enterprises are also featured in the Development Budget. The Government is implementing several key impact programs in 2009, including the Development of Business Growth Centres, the Strategic District Markets Program and the Fisheries Development Project. In addition the National Agriculture Development Plan is being funded in the 2009 Development Budget.

Table 64: 2009 Development Appropriations on Income Earning Opportunities (Kina Million)

	GoPNG	Loans	Donor	Total
National Agriculture Development Plan (NADP)	80.0	0.0	0.0	80.0
PNG Incentive Fund	0.0	0.0	21.8	21.8
Development of Business Growth Centres	20.0	0.0	0.0	20.0
Strategic District Markets Program	20.0	0.0	0.0	20.0
NADP Credit Facility	20.0	0.0	0.0	20.0
Fisheries Development Project	15.0	0.0	0.0	15.0
Other	54.8	5.0	35.6	95.3
Total	**209.8**	**5.0**	**57.4**	**272.1**

Source: Department of National Planning and Monitoring

7.2.7 Law and Justice

Addressing crime and corruption remains one of the country's critical challenges, with the current law and order problem posing a major impediment to economic development. The law and order situation is extremely costly to the nation, through discouragement of saving, business and investment and destruction of public and private properties. Furthermore the current levels of crime and violence substantially reduce the quality of life in both rural and urban communities, especially for women who are at risk from sexual violence and assault. Only by making the probability of punishment for criminal activities higher, will more people move from engagement in such activities to legal economic activities that are of benefit to the nation. To address this challenge, the law and justice sector, has adopted the Law and Justice Sector Policy, which aims to improve the functioning of the formal law and justice system; improve sectoral coordination and resource use; and increase focus on crime prevention and restorative justice.

To improve the effectiveness of the formal law and justice system, crime must be deterred and the rule of law upheld. In particular this goal requires that law and justice agencies form partnerships with communities to enhance service delivery. In particular the sector realizes that the involvement of communities and strengthening of the informal systems is required. In addition, involving communities creates a sense of ownership of the security in the community.

To improve sectoral coordination, the law and justice sector have, since 2006, adopted the Sector Strategy Framework (SSF), which has the overall goal of ensuring '*A Just Safe and Secure Society For All'.* Because all the services in the law and justice sector impact upon each other and affect the overall efficiency of the sector, such a coordinated approach is essential to an appropriate resource distribution.

The Sector Strategy Framework (SSF) focuses on five key areas:

- Improved policing, safety and crime prevention;
- Improved access to justice and results;
- Improved reconciliation, reintegration and deterrence;
- Improved accountability and reduced corruption; and
- Improved ability to provide law and justice services

The SSF provides the structural framework for organization at the sector level and at the agency level, as these strategies are incorporated into all corporate and annual plans. These corporate plans contain key objectives and performance indicators for each results area. Each Corporate Plan also identifies which activities benefit civil society directly and which activities require civil society engagement in its implementation. Furthermore to improve efficiency and impact, agencies are encouraged to submit multi–sectoral proposals in the priority areas and include the role of civil society in the proposal.

The foundation created over the last four years has enabled the sector to seriously start to address reforming the use of Recurrent Budget funds and reform service delivery in priority areas using the Supplementary and Development Budget funds. Priority areas include; Restorative Justice, Good Governance, Corruption and focusing on implementation at the Provincial and Local Government level. Resources for the sector also seek to enhance service delivery at the local level through cooperation amongst agencies, and communities. This includes examining the different components of the Law and Justice Sector at different levels and seeking to strengthen any agency operations that may be weak in order to improve the overall delivery of services at local level. Resource allocation should also include identifying linkages with other agencies and communities to deliver the service on behalf or in partnership the relevant partner agency.

The Sector also has a twofold approach to current social injustice facing women and children of Papua New Guinea by using external and internal strategies. The external focus aims at promoting human rights of citizens through *Convention on the Elimination of All Forms of Discrimination Against Women* (CEDAW), *Convention on the Rights of the Child* (CRC) and with an emphasis on reducing violence against women and children in the country. The internal strategies include encouraging agencies to put in place policies and practices that ensure all employees are treated equitably; gender equality is promoted; greater involvement of women in decision processes of agencies; family and sexual violence issues are addressed; and HIV/AIDS responses are integrated into agencies.

Table 65 shows an increase in Government funding to the sector until 2008 and also recent increases in donor funding in the Development Budget. There is a substantial decrease in Government funding in 2009.

Table 65: Development Appropriations for Law and Justice 2003-2009 (Kina Million)

	Direct Financing	Tax Credit	Loans	Grants	Total
2003	4.0	0.0	0.0	56.9	60.9
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	103.4
2007	30.5	0.0	0.0	96.0	126.5
2008	31.0	0.0	0.0	108.3	139.3
2009	10.0	0.0	0.0	96.0	106.0

Source: Department of National Planning and Monitoring

Table 66 contains the major funding items for the 2009 Development Budget. The Law and Justice Sector Program targets: sustainable service delivery at operational levels, including provinces, restorative justice, including diversion from criminal justice and fraud; and corruption focused on improving service delivery.

Table 66: 2009 Development Expenditure on Law and Justice (Kina Million)

	GoPNG	Donor	Total
Law and Justice Sector Program	10.0	59.4	69.4
Law and Justice Initiative (SGP)	0.0	15.2	15.2
Border Management & Transport Security (SGP)	0.0	10.9	10.9
Justice Advisory Group (JAG)	0.0	5.3	5.3
Other	0.0	5.2	5.2
Total	**10.0**	**96.0**	**106.0**

Source: Department of National Planning and Monitoring

7.3 ECONOMIC SECTORS

7.3.1 Agriculture

Agriculture is an important sector and is key in providing income creating opportunities and sustaining the livelihoods of over 85 percent of the population. Furthermore, agricultural exports contribute significantly to the revenue of the country. In the first quarter of 2008, 18 percent of the total value of the country’s commodity exports was attributable to agricultural exports.

As highlighted in the MTDS 2005-2010, the promotion of agriculture is a significant strategy for achieving export-driven economic growth, rural development and poverty reduction. The sector’s policy focuses on adopting a holistic planning approach to developing the agriculture sector. Consistent with this approach, the Government launched the National Agriculture Development Plan (NADP) in 2007 as the vehicle for engagement of all relevant stakeholders, especially the private sector. To fund the NADP, the Government has committed K100 million annually between 2007 and 2016. The 2009 Development Budget allocates K80 million to NADP projects in the provinces and districts and K20 million for the NADP Credit Facility. The broad components of the NADP are: research and extension; training and information; industrial tree crops, food and horticulture; spices and minor crops; livestock and aqua-culture; gender issues, HIV/AIDS; and strengthening of the NADP management.

In 2008 NADP fully expended the K100 million on 34 projects, which were mostly from private individuals. A total of 300 projects to the value of K900 million have been received and screened for funding under NADP in 2009. The total value of these projects indicates the strong demand for funding in the agricultural sector. While substantial revenue earnings continue to come from the major traditional agricultural crops such as copra, cocoa, coffee, tea, rubber, and palm oil, the Government also plans to extend its focus on exporting spices and nuts. PNG’s spices and nuts have the potential for earning substantial revenue for the country. However, there remain some substantial issues around the NADP, with little impact shown for the amounts expended to date.

However, the agricultural sector is vulnerable to changes in world commodity prices, natural disasters and crop diseases, which can significantly reduce crop yields. These risks represent a significant source of vulnerability for rural incomes and food security. To protect

against some of these risks, the Government heavily promotes Research and Development in agriculture. The National Agricultural Research Institute (NARI) has been highly successful in its innovative research. Some of NARI's research areas focus on finding disease tolerant crops, drought tolerant crops, high yielding crop species, biological control of weeds and techniques for crop yields. The information is packaged and disseminated to small holder farmers through extension officers and trainings.

Another strategy within the Government's Policy for the sector is the rejuvenating of the agricultural assets such as coconut and cocoa plantations. Around 60 percent of the 34 projects funded under NADP in 2008 involved revitalizing the tree crops by replanting new crops.

Lack of infrastructure continues to be a major constraint within the agriculture sector. A good road network is essential for facilitating growth in the sector. Poor telecommunications infrastructure also implies that disseminating vital information to stakeholders in the sector is problematic. The Government has been heavily investing in transport infrastructure and maintenance in recent years. While much of the current focus is on maintaining and rehabilitating existing priority roads, the Government's proposed Long Term Development Strategy is focusing on building new key economic roads that are likely to boost the agricultural sector.

7.3.2 Fisheries

PNG is abundant in marine resources, its fisheries zone of 2.4 million square kilometres being the largest in the Pacific. The fisheries sector, which also includes inland aquaculture, is important to the livelihood of many people in PNG.

The MTDS 2005-2010 recognises the country's comparative advantage in the fisheries sector and as such promotes the sustainable primary production and downstream processing of fisheries. The Government is committed to managing fisheries resources in a sustainable manner and intervening to empower the coastal communities to participate actively in commercial fishing. In this vein the 2009 Development Budget has allocated K15 million for the new Fisheries Development Project, which includes the setting up of fish markets, storage facilities and value adding processing facilities in order to further develop on-shore facilities.

The establishment of onshore downstream processing is important to maximize the benefits of the fishing industry and provide more employment opportunities. Most of the fish caught in PNG waters never reaches the shore in PNG. However, license fees from the fish industry have brought in less than K25 million annually – a minimal amount considering how much the industry is worth in PNG and that it could profit substantially if it engaged in export driven processing, as the value added is much higher for downstream processing. A large percentage of purse seine catch in PNG involves catch and transshipment. Domestic contract loining (South Seas Tuna) and combined domestic catching and canning (RD Tuna Canners) are also present in PNG. A recent study (*DEVFISH*) found empirical evidence to support the views that as on-shore activities increase, benefits to the economy of the tuna industry significantly increase. A strategy must be implemented to re-structure fiscal, operational and management regimes to progressively increase the volumes of tuna processed on shore.

The Pacific Zone Marine Industrial Park, formerly known as the Madang Marine Park, is the government's economic impact project intended to attract more downstream processing in PNG. Unfortunately, the project implementation has barely commenced, even though the project plan has been around for several years. The principal lead agency for coordinating

the implementation of the project has changed frequently over the last few years and currently rests with Industrial Centre for Development Corporation. Progress must be made in 2009, given the importance for the country in job creation and increased revenues in the fisheries sector that are expected to result.
While marine resources form the most important aspect of the fisheries sector, developing the fresh water or aqua culture resources is taking on prominence. The government is promoting inland fish farming, especially in the Highlands. Fresh water trout are relatively cheaply obtained and provide and important source of diet for the people.

The Government and its Development Partners also co-fund some projects, including the Wewak fish market and jetty and the PNG Maritime Boundaries Project (Delimitation Project). The latter project seeks to extend the countries boundaries of PNG's continental shelf by another 150km from its current 200km. If successful, this project will enable PNG to have a much larger marine area, implying more potential revenue from the fisheries sector. However, there will be a cost associated with the surveillance of the extended area.

Some key strategic areas the sector has been focusing on include: improved research, development and information dissemination; easy access to credit services; improved market access for fishery and marine products; and building institutional capacity at both provincial and lower levels to improve coastal fisheries management. However, lack of capacity and funding are the major constraints to objectives that can be pursued in the fishing industry.

PNG has signed an interim Economic Partnership Agreement with EU. It is now in the process of finalizing the legal text of the interim agreement with a view to signing a comprehensive EPA at the end of 2008. The main objective of the Agreement is to obtain better market access for key PNG's exports to the European Union market. The specific details in the EPA will have significant implications for the exporting and competition in the fisheries sector.

7.3.3 Forestry

About two thirds of Papua New Guinea's total land mass of 46 million hectares is forested, making PNG host to the world's third largest rainforest after Amazon and Congo. Of this, it is estimated that 15 million hectares is rich in timber species that is acceptable and accessible for development. This places the ongoing challenge and responsibility on the country for more effective planning, coordination and management of its forest resources to derive the maximum sustainable benefits while minimizing, any detrimental impact to the environment and society at large.

Recognising this challenge, the Government has articulated the need to ensure that these benefits are maximized through '*sustainable primary production and downstream processing*' in the fourth Guiding Principle of the MTDS 2005-2010. The sustainable development of forest resources is also the basis for the National Forestry Policy (1991), whose two core objectives are:

- Management and protection of the nation's forest resources as a renewable natural asset; and
- Utilisation of the nation's forest resources to achieve economic growth, employment creation, greater Papua New Guinean participation in industry, and increased viable onshore processing.

In addition to the National Forestry Policy, the forestry sector also has supporting policies (Draft Reforestation Policy, Draft Downstream Processing Policy and Draft Eco Forestry

Policy), a National Forest Plan, and legislative and regulatory frameworks (Forestry Act 1991, Logging Code of Practice 1996) to encourage sustainable forest management. However, these need to be reviewed and made more relevant, practicable and accommodative to the changing circumstances in areas of forestry. Furthermore, it has been reported that lack of implementation and enforcement of these policies and laws have been due to weak institutional capacity of the PNG Forest Authority (PNGFA) and funding issues restricting effective monitoring and enforcement. It is expected that the finalization of the Reforestation policy would contribute to enhance efforts in sustainable forest management and lead to possible reduction in natural rainforest logging in the long term.

PNG's forestry sector continues to be dominated by large scale logging mainly for log exporting with its largest export timber species being taun, malas, kwila and calophyllum. West New Britain, East New Britain, Western and Gulf provinces represent the highest log exporting provinces. The exports of PNG round logs has increased from 1.4 million cubic meters in 2001 to 2.8 million cubic meters in 2007, the latter valued at over K560 million, calculated at an average price of K202/m^3. With the latest progress on the Government's ten major forestry projects, the increasing trend between 2005 and the first quarter of 2008 in log exports seems likely to continue. The State Purchase Option (SPO) is a statutory requirement stipulated in all approved timber permits that allows the PNGFA access to more than 500,000 cubic meters of round logs based on 25% of the total annual log export quota, on behalf of the Government. To fully operationalise the SPO, PNGFA is currently executing Government direction to establish a State Marketing Agency (SMA) in the structure of the National Forest Service. Once established the SMA would play a key role in marketing and trading of the state's share of log production.

As well as providing significant tax earnings to Government, royalties and levies to landowners are currently estimated at around K30-40 million a year. However, as mentioned, reduced reliance on log exports from natural forests, promotion of plantation forestry and more downstream processing of forest products could provide more long term sustainable benefits to the economy of Papua New Guinea.

In 2008, one of the significant accomplishments of the PNGFA has been the completion of the Guidelines on Forest Clearance Authority (FCA) for large scale agriculture and other land use development, which has been endorsed by the National Forest Board. The development of these Guidelines was critical given the current trend of clearance of large areas of natural forest. Initially, the Forestry Act 1991 had provisions primarily for pure forestry operations and only permitted forest clearance of areas not exceeding 50 hectares for agriculture and not exceeding 12.5 kms for road constructions. However, amendments to the Act in 2000 made provisions to exceed these limitations and thus created a need for the Guidelines of FCA. This has been envisaged as timely and useful to enhance the implementation of the Government's National Agriculture Development Plan (NADP) which will involve large scale forest clearance for agriculture development. However, there remains a concern that the project proponents may not fully implement the project objectives and instead abandon it after benefiting from forest activities. Hence, the effective collaborative efforts between the Department of Agriculture and Livestock and PNGFA are critical.

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/m^3 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. However, there may be a need to create more awareness on this tax regime in order to clear any misunderstandings from the industry and landowners.

The log monitoring and reporting activity carried out by the Government funded SGS company since 1994 has proven beneficial in terms of detecting inaccurate reporting of log exports by companies. By detecting and correcting these discrepancies, additional export levies, additional foreign exchange and tax revenue, which could otherwise have escaped the Government, are being collected. 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.

PNG is a signatory of several international agreements and conventions, including the International Tropical Timber Agreement (ITTA); UN Forum Convention on Climate Change (UNFCCC); Kyoto Protocol (KP); Convention on Biodiversity Conservation (CBD); and UN Convention on Desertification. These are global opportunities available to PNG to explore for the sustainable management of its forests. PNG has already established itself as a key advocate in these areas at the global level, and needs to develop relevant programs in order to participate and benefit more meaningfully from monetary and technical assistance available under these international agreements.

Climate change is increasingly becoming a global concern for which forests play an important part in carbon sequestration. PNG had been instrumental in forming the Coalition of Rainforest Nations to push for compensation to developing nations for reduced emissions from deforestation and degradation (REDD). The COP 13 Meeting in Bali was an important step in acknowledging REDD and in including it in further climate change negotiations. At the current rate of deforestation either through logging activities or clearance of forests for conversion to agriculture, the objectives of REDD cannot be met. PNG will need to seriously address this issue otherwise it may not be able to benefit from incentives that will be provided by the international community. In view of the above, the PNG Forest Authority has developed a draft Forestry and Climate Change Framework for Action that is intended to be incorporated into the National Policy on Climate Change when it is finally ready. Furthermore there is a lot of political support for venturing into carbon trading both from reforestation and afforestation and REDD.

7.3.4 Tourism

Papua New Guinea has many attractions for tourists, including natural beauty, world-class diving, unique bird watching, deep sea fishing, cultural richness and trekking, in particular the Kokoda Track. At present tourism contributes around K500 million to the PNG economy. There was a recorded increase of tourists from 22,919 in 2006 to 27,737 in 2007, although these figures may include business migrants falsely claiming to be tourists. However, the tourism industry has the potential to further increase GDP, Government revenue and foreign exchange earnings, as well as to increase formal employment and informal income earning opportunities, including through demand for Papua New Guinean cultural arts and crafts.

The overall goal of the tourism sector is to '*increase the overall economic value of tourism to the nation by doubling the number of tourist on holiday in PNG every five years and maximizing sustainable tourism growth for the social and environmental benefits for all Papua New Guineans*'. If this goal is achieved, the *PNG Tourism Sector Review and Master Plan 2007 – 2017* estimates that this would result in:

- Tourism would be worth K1.1 billion by 2010 and K1.78 billion in revenue by 2015.
- Holiday makers would spend K363 million in 2010 and K727 million in 2015;
- Total employment in tourism sector would increase by 4,800 jobs by 2010 and 13,000 by 2015.

Over the past four years the Government has recognized the potential of the industry and as such, has classified tourism as an economic sector that must be promoted. The MTDS 2005-2010 states that PNG's comparative advantage in tourism must be promoted. Through the Development Budget, several projects have been funded in the tourism sector, including the Kokoda Track Development, Model Provinces Development, Small Medium Enterprise (SME) Tourism Loan Facility, of which in the 2009 Development Budget the latter project has been allocated K1 million. The SME Tourism Loan facility is supported by the National Development Bank and has been successful in helping Papua New Guineans to obtain finances in the form of a loan to assist with small scale tourism projects.

The Government has also introduced other initiatives to boost the industry further. Since 2004 taxation incentives have been in place to encourage more marketing and promotional activities overseas by tour operators and hotelier sub-sectors., which is likely to have significantly increased the number of overseas tourists. The Tourism Master Plan 2007-2017 (TMP) has been launched and will provide guidance to the sector's growth and development for the next ten years. The key objectives of the TMP include: developing PNG as a globally recognized destination offering a range of unique niche tourism experiences; generating investment and employment through profitable business opportunities and subsequent development of the economy; celebrating, protecting and enhancing PNG's unique cultural heritage and natural environment by showcasing these attributes; providing visitors with an enjoyable, distinct and memorable experience; demonstrating partnership and collaboration across all stakeholders; and providing a broad distribution of benefits across PNG thereby improving the lifestyles of rural and urban communities. Effective implementation of the TMP should deliver further sustainable benefits to the economy.

Successful implementation of the TMP is crucial to maximize the net benefits from the tourism industry and achieve all the TMP's objectives. As such the 2009 Development Budget has allocated K3.5 million for the implementation of the TMP. To facilitate implementation, a review of the Institutional arrangements within the Ministry of Tourism and Culture's portfolio is currently being undertaken. The Review aims to assess the current institutions (PNG Tourism Promotion Authority, the National Cultural Commission and the National Museum and Arts Gallery), their linkages, and their capacity with the aim of proposing an appropriate structure which could help support and enhance the growth of tourism and culture, both at the national and provincial levels and foster a more effective partnership and collaboration between the institutions. The review is yet to be finalized, but consultations with relevant stakeholders have already commenced and will continue in 2009.

Despite the fact that some limited progress has been made in the sector, the Government must address the major impediments to tourism, which include the law and order problem, poor transport infrastructure and the high cost of air travel.

7.3.5 Oil and Gas

The oil and gas industry in PNG has contributed immensely to improving the economy of the country since the 1990s. The industry is estimated to have contributed over K1 billion to real GDP over the period of 2005 to 2008. However, PNG's oil production is showing a downward trend due to a natural decline in the current oil fields. Therefore gas has the potential to become PNG's most important natural resource.

Since the abandonment of the PNG Gas to Queensland Pipeline Project in 2006, the commercialization of gas has remained an important agenda for the Government. The Government is pursuing this in partnership with ExxonMobil through the PNG LNG Project.

The PNG LNG Gas Agreement was signed between the Government of PNG and ExxonMobil on 22nd May 2008 which paved way for the FEED (Front End Engineering Design) entry decision by the co-ventures. Gas commercialisation for PNG shows great potential as indicated by the big interest of international companies already initiating discussions with the Government.

The project is expected to yield large economic benefits, including an increase of around K10 billion in real GDP each year during the operational phase. The project has an expected life of 30 years and is the largest private sector investment that has ever been considered in PNG. It will lead to large Government revenues and direct cash payments to landowners. Other benefits include the large number of jobs that would be created and the resulting multiplier effect on economy. However, the project also comes with economic challenges, including Dutch Disease effects, which could be detrimental to the other economic sectors. Strong governance and transparent public financial management will be crucial in translating the economic benefits into improved living standards for the population.

As per the PNG LNG Gas Agreement signed in May 2008, the decision on the State Nominee to be the custodian of the States' equity in the project must be made within 180 days after the signing. In October 2008 the NEC nominated the Independent Public Business Corporation (IPBC) to be the State Nominee, who will make the decision on the financing options to fund the State Equity in the LNG project.

The Government must continue to have a pro-active approach in further developing its oil and gas industry as it ventures into establishing the regulatory and policy environment to accommodate for the entrance of ExxonMobil and its co-ventures in the integrated LNG project. More importantly, the Government must be cognizant of various landowner issues, deal with those issues, expectations and demands that will arise as a result of different ethnic groups that are affected by the project footprint, which covers four provinces (Southern Highlands, Western, Gulf and Central Provinces). The Benefit Sharing Agreement (BSA) and National Content Plan decisions are likely to be a challenge for Government as it consults with all stakeholders including the affected area landowners of the project (whose clans or groups would be incorporated under the Land Groups Incorporation Act), affected Local-level Governments and affected Provincial Governments. Even though the Government has been involved in such negotiations before in existing oil and gas projects, the LNG project will have intensified challenges due to the much larger scale of the project.

The Government has now formulated new regulations and regulatory amendments as deemed necessary by the PNG LNG Gas Agreement. These relate to tax exemptions, insurance, labour, pricing, and valuations, which was endorsed in September 2008. The Oil and Gas Act 1998 and the Oil and Gas Regulations 2002 have been amended and inclusions made accordingly for the LNG project to progress.

Although there has been a general decline in oil production, revenues from the oil industry can be increased further by engaging in downstream processing of current and newly discovered oil fields. The development of a petrochemical industry at Konebada Petroleum Park and the proposed gas pipeline will enable such downstream processing to take place.

Under the 2008 Budget K50 million was allocated for the Konebada Petroleum Park infrastructure. In addition some new field discoveries are being made including the gas and condensate discovery at the Japan Energy Corporation's Cobra 1A well located in Gobe, Southern Highlands Province.

7.3.6 Mining

PNG's mining sector continues to be a major export earner for the country since the early 1970s. Recent high prices of minerals, namely gold, silver and copper, in the world market has further boosted revenue earnings from the mining sector, leading to large Supplementary Budgets since 2006. Most of the new mines will enter their production phase from 2009 and there are still more potential mining lease areas indicating a favourable outlook for the industry's contribution to export earnings and GDP over the next ten to twenty years.

The Government's experience in the mining industry over the years has resulted in the evolution of an enabling policy and regulatory environment that provides incentives for developers to invest in the mining industry in PNG. The fiscal incentives and less rigid policy stance by Government, combined with the current high mineral prices, have led to a rapid increase in exploration activities and indicate great potential for further growth in the industry. The number of Exploration Licence (ELs) applications in 2008 totalled 82 of which 47 ELs were issued and 35 were renewals. There are 13 advanced exploration projects nearing pre-feasibility or feasibility stages with significant drilling programs currently underway. The sector has been further developed with the inclusion of Simberi Gold Company Ltd and Mt Sinivit (Wild Dog) Ltd to current operating mines namely Lihir Gold Ltd, Ok Tedi Mining Ltd, Porgera Joint Venture Ltd, and Kainantu Gold Ltd. Upcoming mines include Hidden Valley Ltd that will commence production in the 2nd quarter of 2009 while Ramu NiCo Management Ltd will commence production in early 2010.

The world's first off-shore Exploration Licence was issued by the Government of PNG to Nautilus Minerals in 1999 for the mining of gold, silver and copper in the Bismarck Sea at depths of 1,000 metres. The use of innovative engineering and the use of remotely operated robotics will feature in the mining operations that will lead to a production rate of 1.8 million tonnes annually when it starts operations in late 2009. PNG is also diversifying its mining industry with the granting of a mining licence to the Metallurgical Chinese Corporation to mine nickel and cobalt in the Ramu District, Madang Province, in 2007. The production rate from the Ramu project is expected to be 33,000 tonnes of nickel and 3,300 tonnes of cobalt for a 20 year period starting in 2009.

Though there is large potential for the industry to expand at a fast rate, there is also a growing concern on the environmental impacts of these mines. The disposal of mine waste has been an issue for PNG, for example the Ok Tedi Mining Ltd court case, and the accusations made against Tolukuma Gold Mine Ltd for disposing mine waste into the Angabanga River. The Department of Environment and Conservation (DEC) is the agency responsible for conducting Environmental Impact Assessments of development projects such as mining, and needs the necessary resources to perform its mandated responsibility effectively. As such DEC was allocated K1 million for Mine Monitoring in the 2009 Development Budget.

Another issue is the benefits that should be conferred to the landowners, Provincial Governments and Local Level Governments of the mine impacted areas. There is a concern that benefits such as MOAs for infrastructure projects and royalties are being misused by the leaders/chairmen of the Landowner Associations and that members are losing out on benefits including health, education and transport services.

To better assist the Government to effectively manage and administer the mining sector, the Mineral Resources Authority (MRA) was established in 2006. The MRA's role is to perform the technical and operational roles relating to the administration and management of the mining sector - functions which were previously under the Department of Mining. The tasks

include the regulatory operations of mineral tenements management, responsibility for mining safety and technical and coordination functions of project coordination and liaison, geological survey, and conducting promotional activities on PNG's mineral potential. The Department of Mineral Policy and Geohazard Management retains its responsibility for the development and maintenance of the policy and regulatory environment of the mining industry as well as performing its function in the monitoring and management of hazards relating to volcanic activity and earthquakes.

7.3.7 Manufacturing

The Government is committed to increasing the value of exports produced by Papua New Guinea's manufacturing sector. This has the potential to increase formal employment growth and broaden the tax base. However, despite the potential investment opportunities in downstream activities, at present PNG imports almost all processed food, clothing, footwear and inputs for industry and commerce.

The Government has put into place strong policies which will lead to the development of a strong domestic production base to replace reliance on the non-renewable resource industries such as mining and petroleum. The Government seeks to encourage value adding of the country's natural resources by manufacturing them into finished products such as petrochemical, canned tuna, furniture, biofuel - both for domestic consumption and exports. The tax incentives and concessions granted to businesses under the import substitution policy as well as creation of special industrial zones are policy interventions aimed at encouraging domestic processing.

The Government needs to be consistent in its efforts to removing impediments to business and investment in order to effectively address prevailing problems including the costs associated with security, insurance and transportation being faced by the industry. Infrastructure improvements and lowering of input tariffs would greatly reduce production costs. The manufacturing industry has been urged to adopt cost-reducing, efficient techniques on the factory floor and within management to prepare itself for foreign competition when protective tariffs are phased out.

The Tariff Reform Program (TRP), which was introduced in 1999 and reviewed in 2007, was aimed at relaxing duty rates of most goods with exception of goods that are produced or could potentially be produced in PNG to be set at zero. Under this structure most of PNG's imports now enter the country duty free, but the benefits from tariff reform are difficult to measure. Despite many impediments to business, the PNG manufacturing sector is expanding with small increases to real GDP estimated over the past few years and a further small increase projected for 2009. Parallel to the introduction of the TRP, the government introduced a Value Added Tax (VAT) now named Goods and Services Tax (GST) to offset revenue losses from reduced tariffs and to replace provincial sales taxes. Protection of domestic industries also results in negative rates of protection for export industries that have to sell their outputs on world markets at international prices while purchasing inputs from protected local industry at higher than world prices. In this case the negative effective rate of protection is a measure of the penalty imposed by the tariff structure on export industries.

The reduction in effective protection of local industry and a negative effective protection for export industries represent very substantial achievements of the TRP, which is consistent with the requirements of World Trade Organisation. The tariff reform has brought about a substantial improvement in the efficiency of resource use across Papua New Guinea industries.
The contribution of manufacturing sector to the real GDP growth was projected to decline to 0.3 percent in 2007 compared to 0.4 percent in 2006. The expected decline was mainly due

to effects of high oil prices impacting business growth, scaling down of production by a major oil refinery as a result of mineral companies importing fuel directly from overseas suppliers; and lower shipments of processed coconut oil to overseas markets due to delays in shipment. In 2007, the total nominal value of sales in the manufacturing sector increased by 7.5 percent. The manufacturing sector, including downstream processing of natural resources and the manufacture of industrial goods, is targeted for greater expansion from 2009 onwards.

The challenge remains for the Government to play a proactive role to create an enabling environment that will allow local industries 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. The substantial growth in formal employment in the recent past from the manufacturing sector needs to be sustained. Much of these increases are 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. Other major initiatives are expected to further promote growth in the manufacturing sector and its contribution to the economy and Government revenue in the medium term. These initiatives include the LNG processing and exporting plant and the associated developments and spin offs of a petrochemical industry as a key component of the Gas Commercialization Strategy, and the fisheries, cassava, sago and palm oil processing projects.

7.4 ENVIRONMENT

Environmental sustainability is a unique challenge for PNG. Being one of the most bio-diverse countries in the world, containing one of the largest forest areas (29 million hectares) in the world and having a large proportion of the population whose livelihoods depend on resources such as fish, forestry, land and water resources for agriculture and natural resources for food and shelter, the importance of the environment for PNG is immense. PNG’s natural beauty and endemic species are irreplaceable.

However, the current trend is not encouraging. Fisheries are declining and forest areas are decreasing rapidly. Urbanisation, poverty, industrialisation, lucrative natural resource development, growing demand for energy and growth population rates put additional pressure on the environment. Furthermore PNG is particularly vulnerable to the effects of climate change such as cyclones, drought, rising sea levels, floods, tsunamis, landslides and bush fires. Environmental experts have predicted that in the near future, PNG will struggle to provide the large amounts of funds that will be necessary to cope with such disasters.

The MTDS PMF environment indicators for Department of Environment and Conservation (DEC) investigation of pollution complaints (only half of the complaints registered were investigated in 2007) and the international performance rankings for environment protection in PNG reflect poor performance. However, some improvements are being made recently. PNG was marked only 1.5 on a scale of 1 to 6 in 2005 and 2006 for the responsiveness of its policies and institutions to environmental concerns by the *World Bank’s Country Performance and Institutional Assessment*, however, this improved to a score of 2 in 2007. Data on the proportion of undeclared logs discovered also shows slight improvements. However, monitoring of progress and improved indicators for the environment are necessary.

For these reasons, the environment and geophysical sector must be considered a priority area for the country’s development efforts. The Government must ensure that long-term

sustainable socio-economic growth and development are achieved while not compromising the environment in the process. The MTDS 2005-2010 has acknowledged the importance of balancing protection of the environment with development aspirations, and underscored the need for ‘ecologically sustainable development’. This challenge implies that the environment must be recognised as a cross-cutting issue in all development plans.

Future development strategies, such as the proposed Long Term Development Strategy (LTDS), will need to go a step further than the current MTDS and promote the mainstreaming of environment into economic and development planning; developing and implementing strategic environmental plans and sustainable development indicators; take measures to manage the conflict between economic developments and social costs; and the increased involvement and coordination of relevant stakeholders in achieving sustainable development goals. Furthermore, when formulating strategic plans, lessons learnt from past natural disasters and environmental risks to future investments must be considered.

Papua New Guinea’s natural environment is currently managed by the Department of Environment and Conservation (DEC). DEC tries to maintain its strategic focus by helping address environmental issues arising from maritime exploitation, environmental impact and assessment, environment protection, water resource management, compliance and enforcement, conservation, parks and wildlife, and now climate change. Through DEC, the Government is pushing not only to protect and preserve the environment, but to apply the techniques of ‘sustainability’ for all its development projects and programs. The Government of Papua New Guinea is a signatory of international agreements including the Kyoto Protocol and the Millennium Development Goals (MDG), which aim to ensure environmental sustainability (MDG 7) by integrating the principles of sustainable development into country policies and programs and to reverse the loss of environmental resources by 2015. MDG 7 also promotes the improvement in the lives of slum dwellers and the proportion of people with access to safe drinking water and basic sanitation.

DEC has several ongoing projects to promote environmental sustainability under the 2009 Development Budget, including Mine Monitoring (K1 million), Biodiversity Development Program (K300,000) and Protected Areas and Clean Development Mechanism (CDM) (K300,000). The Government has also approved new initiatives such as the *Water Policy* and *Land Development Project* to support the effort of sustainable environmental development and simultaneous economic improvement. Development Partners are also investing in various elements of environmental sustainability such as the Global Environment Facility, administered by DEC on issues such as adaptation and mitigation to climate change. Establishment of the Office of Climate Change and Carbon Trade in May 2008, which aims to coordinate between the agencies and stakeholders on issues relating to climate change and carbon trading, reflects the Government’s commitment towards and ownership of the effort to tackle climate change and benefit from carbon trading.

Other steps taken by the Government is the instruction to relevant central and line agencies and authorities to establish a Technical Committee to provide oversight and coordination of the PNG environmental sustainable economic growth and the PNG Carbon Emission Initiative. Furthermore, at the 2005 United Nations Summit on Climate Change in Montreal, PNG led a coalition of developing countries in proposing a plan whereby developed countries would pay developing countries to preserve their rainforests. In March 2008 Prime Minister Somare and Prime Minister of Australia, Kevin Rudd, signed the Papua New Guinea – Australia Forest Carbon Partnership. This Partnership addresses environmental challenges by improving livelihoods for forest dependent communities; promoting protection of biodiversity; Reducing Emissions from deforestation and forest degradation (REDD); forest carbon monitoring and measurement; and supporting PNG’s participation in the emerging international carbon markets.

CHAPTER 7. SECTORAL POLICIES

7.1 OVERVIEW

As outlined in Chapter 6, the Medium Term Development Strategy consists of seven Expenditure Priority Areas (EPAs), which this Chapter first reviews. These are:

- 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

For each of the seven EPAs, it considers the relevant policies and plans, major activities, progress and issues and challenges. It also lists the major development expenditure items under each of the seven priority areas and provides an overview of Development Budget funding since 2003.

The Chapter then turns to a review of Papua New Guinea's key economic sectors, as identified in the MTDS.

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

Finally the Chapter reviews progress made in addressing environmental issues, an area critical to sustainable development for Papua New Guinea.

7.2 MTDS EXPENDITURE PRIORITY AREAS

7.2.1 Primary and Preventive Health care

The National Health Plan 2001-2010 provides the overall policy and planning directives for the health sector. Its goal is to improve the health of all Papua New Guineans through the development of a health system that is responsive, effective, affordable, acceptable and accessible to the majority of the people. More focussed strategic priorities of the National Health Plan are provided in the Strategic Plan and include: immunization of every child under one year old, reduction of malaria and TB, prevalence in high endemic malaria/TB areas, reduction of maternal mortality in high risk areas and reduction of the increases of HIV and STI). The health sector Medium Term Expenditure Framework guides this approach by allocating resources to these priorities. In 2009 the same strategic public health directions will be targeted.

The challenges for health service delivery are complex. The current health system is not responsive to the population's needs for service because of fragmentation of health systems structures caused by the Organic Law and the operation of two varying legislations in the

CHAPTER 8. MEDIUM TERM OUTLOOK

8.1 OVERVIEW

The global economic outlook has deteriorated markedly over the last year. Whereas the world economy had been growing above trend for the past five years, the IMF is projecting a significant slowdown in 2009, with the developed economies expected to enter a recession, and the developing economies, particularly China and India, expected to slow down significantly.

Growth prospects for the United States have deteriorated sharply in 2008 and are expected to further weaken in 2009 as the country's consumption, investment and industrial production contracts. The outlook for the Euro area has also deteriorated, with sluggish private consumption growth and a contraction in investment expected to weaken GDP growth in 2009. The outlook for Japan has also been revised down due to a broad-based deterioration in the country's economic confidence. China and India's growth prospects have also weakened in 2009.

This has significantly altered the outlook over the medium term. The most important impact for PNG is that the economies that are slowing down or entering recession are the major users of PNG's commodity exports. The drop in demand for these commodities, such as copper, oil and gold, has resulted in sharp price falls. Over the past four months, the prices of these commodities have fallen by more than half, resulting in a significant decline in export revenues.

This has reduced the Government's medium term revenue projections significantly, with no additional mineral revenue expected under the medium term commodity price projections, which are based on 10 year average prices. This will translate into a projected decline in Government expenditure, relative to the elevated levels over recent years, when windfall revenues have funded additional priority expenditures.

In spite of the global turmoil and falling commodity prices, growth prospects for PNG in 2009 remain relatively favorable, before slowing somewhat in the outyears. However, the bulk of the slowdown can be attributed to the declines in oil production, which will continue to decline as existing fields mature. The non-mineral sector is expected to continue to grow over the medium term, due largely to the relatively insulated nature of much of the sector to global conditions.

The deceleration in the global economy is expected to help dampen inflationary pressures in 2009, as weaker demand from advanced economies lowers the prices of most commodities including oil and some foods, particularly wheat and rice.

In PNG, annual inflation as measured by the consumer price index (CPI) is projected to be 6.1 per cent in 2009 down from 10.6 per cent in 2008. This is largely due to the reversal of international factors that were in part driving inflation and the strengthening of the exchange rate. This outlook does not reflect any easing of domestic inflationary pressures as the prices of basic goods and services within the domestic economy have continued to increase.

On the external front, the exchange rate will continue to be set by the market, with the Bank of PNG's relatively high level of foreign reserves more than sufficient to perform the role of appropriately managing short-term exchange rate volatility.

The current account is anticipated to move sharply into deficit in 2009, following large surpluses in recent years. This is due to the large declines in commodity prices translating through into sharply lower export values. At the same time, import values are expected to remain at relatively elevated levels, due to the impact of the Ramu Nickel project and continued strong domestic demand. Over the medium term, the current account deficit is expected to stabilize as the economy adjusts, however deficits are anticipated to continue.

Over the medium term, the Government will seek to: improve the country's infrastructure conditions; improve basic service delivery to the vast major of its people; strengthen the agriculture, forestry and fishing sectors; attract new investments in the mineral and energy sectors; and create an environment conducive for businesses and investments.

8.2 WORLD ECONOMIC OUTLOOK

8.2.1 World Economic Growth

Since the emergence of the sub-prime mortgage crisis in the United States in 2007, the global economy has deteriorated considerably. Not since the Great Depression in the 1930s have world financial markets experienced such turmoil and weakness – stock markets across the globe have fallen by more than 40 per cent since their peak, many financial institutions have collapsed and finance has been much harder to raise on world markets, as risk is being repriced.

A number of the world's largest banks and financial institutions, including Lehman Brothers, Bear Stearns, American International Group, Fannie Mae and Freddie Mac have either failed or been bailed out. The financial crisis has not been restricted to the United States. Financial institutions have also collapsed in the United Kingdom, Germany, France, Ireland, Belgium, Luxembourg, Iceland and the Netherlands.

The failure of these financial institutions, and the potential failure of a number of others, has created great uncertainty and fear across financial markets. Banks have been unwilling to lend to each other or other businesses, out of fear that the borrowers will fail and be unable to repay the debts. This has caused a credit crunch, resulting in a significant increase in risk premiums, increasing the cost of borrowing significantly.

The impact of the global financial crisis and credit crunch is drastically reducing growth prospects in the global economy. It seems likely that the United States will enter a recession this year, the Japanese economy has already entered recession, the European economy has slowed considerably, and there are early signs that the Chinese and Indian economies have beginning to slow.

The deterioration in the global economic situation is unfolding rapidly, making it particularly difficult to develop an understanding on how things will turn out. Less than one month after releasing its biannual World Economic Outlook, the IMF has had to release an updated Outlook, revising most of the projections down.

The IMF is now predicting a recession in the developed economies, with growth in 2009 contracting for the first time in the post war period. Growth in emerging and developing economies has been revised down to 5 per cent in 2009, the slowest growth since 2002, and a slowdown of similar magnitude to developed economies when considered relative to trend.

This is resulting in a significant fall in commodity prices. While this will affect growth prospects in commodity producing economies, combined with increasing levels of economic

slack, it will help contain inflation pressures. The reduction in inflationary pressures will increase the room available for policy makers to respond to the global slowdown – although as seen in the US and Japan, the available options, in the form of lower interest rates and options for fiscal stimulus, are limited.

Looking ahead, the economic outlook is particularly uncertain. Financial conditions continue to present serious downside risks. If firms and households continue to reduce debt levels, through cutting consumption and investment expenditure in order to repay debt and increase savings, this could prolong the slowdown and increase its intensity. The IMF also warns of the risk of substantial capital flow reversals and disorderly exchange rate depreciations for many emerging markets. In the current setting, the IMF considers that upside risks are limited.

8.2.2 Inflation

Globally, there has also been a surge in inflation especially in the emerging and developing economies over the past few years, with an increase in the price of food and fuel and a more general tightening of capacity constraints.

The sharp weakening of the global economy is also expected to help dampen inflationary pressures in 2009. Weaker export demand from advanced economies has lowered the historically high commodity prices of oil, copper and gold. This, together with higher amounts of spare capacity in major economies will assist to reduce inflationary pressures.

In spite of the recent deceleration in the global growth in 2008, headline inflation has continued to rise around the world to the highest rate since 1990. The rise in inflation has been more marked in the emerging and developing economies, reaching 8.25 per cent.

8.3 GROSS DOMESTIC PRODUCT

8.3.1 Overview

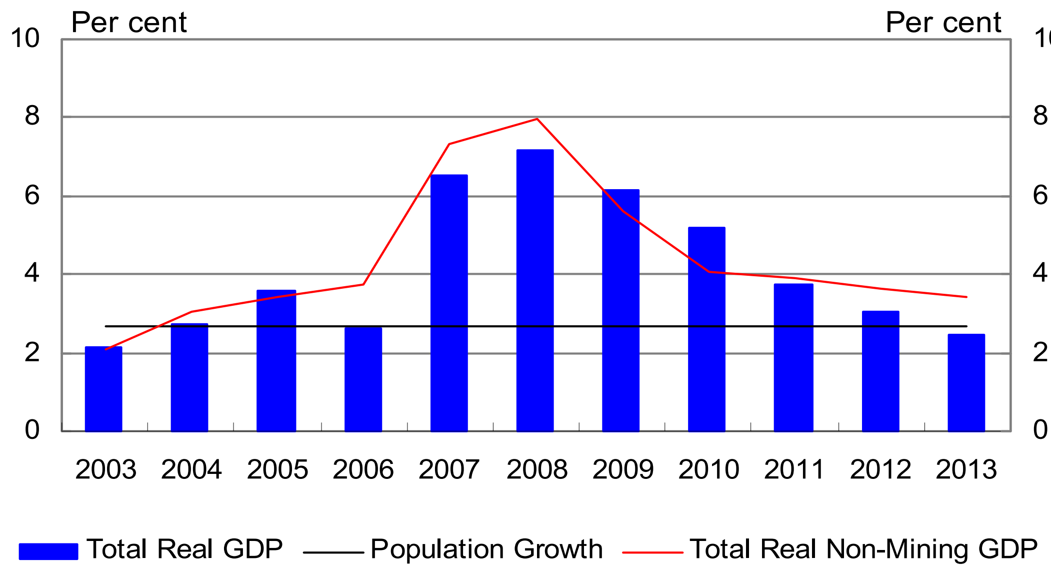
Economic growth in PNG is expected to continue to be strong in 2009, with real GDP forecast to increase by 6.2 per cent, and non-mining growth is forecast to increase by 5.6 per cent. This represents a moderation from the very strong growth rates in 2007 and 2008, and is a reflection of the mobile phone sector continuing to expand, but at a slower pace; as well as the large scale expansion in the building and construction sector running up against capacity constraints, reducing the scope for further expansion in activity.

Generally, the solid economic outlook is expected to continue from a combination of continued political stability, microeconomic reforms, prudent macroeconomic policies, relatively low interest rates and high but manageable inflation levels.

Over the medium term, the economy is expected to continue to grow but not at the same rate as recorded over recent years. This is largely a reflection of the natural decline in oil production from existing oil fields, and an easing of growth in the mobile phone sector.

Most other sectors are anticipated to continue to return to around trend growth rates over the projection period, with the exception of building and construction. Above trend growth in construction is expected to continue over the next few years, in line with increased Government expenditure on infrastructure projects, sourced from funds accumulated in trust accounts during the commodity boom.

Figure 15: Real Economic Growth 2003 – 2013



Source: Department of Treasury

In order to assist continued private sector expansion, the Government needs to pursue structural reforms aimed at sustaining and improving economic growth prospects. Such microeconomic reform in the telecommunication industry has led to large expansion in the mobile phone industry, which has contributed to broader and improved services, increased employment, increased investment in infrastructure, and caused a significant reduction in prices. The experience of this sector provides a guide to the potential benefits of reforms in other sectors.

One major factor that has the potential to change the overall picture of the economy over the longer term are the massive Liquefied Natural gas (LNG) projects that are being considered. The project most likely to proceed is the Exxon Mobil led LNG project, drawing gas reserves from the Hides, Angore, Juha, Gobe, Moran and Kutubu fields in the PNG highlands, which will then be piped down to a liquefacation plant near Port Moresby. A decision will be made towards the end of 2009 following the completion of the Front End Engineering and Design (FEED) stage), about whether the project will go forward. Given this uncertainty, the project has not been included in the medium term projections.

Treasury analysis estimates that it will have a substantial impact on gross domestic product once production begins, in late 2013 or early 2014, and a smaller impact during the construction phase. This analysis is presented in Section 8.4.

8.3.2 Agriculture, Forestry and Fisheries

The Agriculture, Forestry and Fisheries sector is projected to grow strongly at 4 per cent in real terms in 2009. Over the medium term, the sector is expected to continue to grow, driven by expansion in the palm oil, copra oil, cocoa and coffee industries.

The Forestry sector is projected to grow by 2.4 per cent in 2009, reflecting increased production from impact projects. However, over the medium term, falling production from

larger existing logging projects is expected to outweigh the increased production coming from the new, smaller scale impact projects, resulting in a trend decline in production.

The Fisheries sector is projected to continue to grow at a rate of 3.5 per cent in 2009. Solid growth is anticipated to continue over the medium term, in line with increased investments in local wharves and jetties.

8.3.3 Mining and Petroleum

The mining and quarrying sector is projected to grow very strongly at 17.5 per cent in 2009, driven by a ramp up of production from the major existing mines, supported by the expected commencement of production from the Hidden Valley gold mine during 2009.

Gold production is expected to increase very strongly in 2009 with the major mines of Lihir and Porgera ramping up production combined with normal production from the Ok Tedi mine, reflecting the major expansion plans following the large capital expenditures in previous years. The robust growth is expected to be further supported by the commencement of the Hidden Valley gold mine combined with normal production from other smaller mines.

Copper production from Ok Tedi is also forecast to be higher in 2009, reflecting production returning to normal after lower production in 2007 and 2008, due to mining of lower ore and temporary problems with crushers. Ok Tedi is anticipated to continue to produce copper and gold at around current levels up to and including 2013, before closing in 2014 (outside of the projection period). There are a number of options for extending the mine life being considered at present, although these are at early stages of consideration, and are highly uncertain.

In the medium term, the mining and quarrying sector is expected to continue to grow strongly, reflecting the commencement of production for Ramu Nickel in early 2010. However, growth is expected to moderate at the end of the forecast period as the major mines mature.

Ramu Nickel is anticipated to begin nickel and cobalt production by 2010, ramping up to full capacity in 2011, with production expected to remain steady thereafter.

The Lihir gold mine is anticipated to continue to expand production up until 2011, when production is expected to hold steady at high levels. There is potential for further increases beyond this, in line with the million ounce upgrade announced by Lihir Gold.

Porgera Joint Venture is anticipated to continue to ramp up gold production, with production expected to peak around 2010 and 2011, before declining, as the mine approaches the end of its mine life around 2020.

The petroleum sector is projected to decline by 7.3 per cent in 2009, as production from existing fields continue to decline as they mature. Over the medium term, oil production is expected to continue declining, reflecting the depletion of oil reserves from existing fields. Some of the fields like Gobe are expected to cease operation before the end of the forecast period and by 2015 the oil reserve is forecast to be completely depleted.

The LNG projects that are currently being considered have the potential to increase production in the oil and gas sector substantially over the medium term. Production estimates from the Exxon Mobil led LNG project suggest sustained annual production levels

in the range of 60 million barrels of oil equivalent over the 20 year peak production phase of the project.

This compares to the current production of 15 million barrels from existing projects, and is broadly similar to the initial rate of production from the Kutubu field when production first began in the early 1990s. However, LNG production is not expected to begin until 2013 at the earliest.

In the medium term, commodity prices are assumed to return to 10 year averages of US$3540 per tonne for copper, US$46 per barrel for oil and US$445 per ounce for gold.

8.4 The Potential Economic Impact of the LNG Project on the PNG Economy

The proposed LNG project, undertaken by an Exxon Mobil led joint venture, is anticipated to be the largest project undertaken in PNG to date. The project will involve drawing gas from the Hides, Angore, Juha, Gobe, Moran and Kutubu fields in the Southern Highlands which will then be piped down to a liquefaction plant near Port Moresby, before being exported as LNG. The project will also produce relatively small quantities Liquefied Petroleum Gas (LPG) and Condensate, a form of oil.

Given that the project is yet to be sanctioned to proceed, the economic impact on PNG has not yet been factored into the baseline GDP forecasts. The following Treasury analysis has been prepared in order to provide some guidance about the potential economic impact on the PNG economy if the project does proceed, and draws on assumptions prepared by ACIL Tasman.[2]

The early estimates of the construction cost of the project were approximately US$10 billion, or K26 billion over the life of the project, with an initial cost of US$8.3 billion. Approximately US$5.5 billion of the total construction cost is assumed to be used for equipment with the remaining US$4.5 billion going towards labour costs (Figure 16).

Since the early estimates were assembled, cost estimates have increased further, although cost estimates will be clearer when the FEED stage is completed in late 2009. At the end of the FEED stage, the investment partners will make a decision about whether the project proceeds.

The LNG project is expected to commence production in late 2013 or early 2014, ramping up to a maximum capacity of 6.4 million tonnes of LNG per annum (mtpa). This translates into approximately 54 million barrels of oil equivalent (mboe), a significant increase over the current level of oil production from existing fields of around 15 million barrels per year. Combined with the production of condensate and LPG, the Project is expected to produce around 60 mboe during the peak production period.

To provide some context, the Kutubu oil field produced around 45 million barrels of oil when it first came on stream in 1993 and 1994 (Figure 17). However, oil production from Kutubu declined rapidly as the field matured and output halved within 6 years. In contrast, the LNG project is expected to sustain production at around the 60 million boe level over the first 20 years, before tailing off as the project matures.

[2] ACIL Tasman (2008), PNG LNG Economic Impact Study

Figure 16: Total Direct Activity from Different Stages of the LNG Project

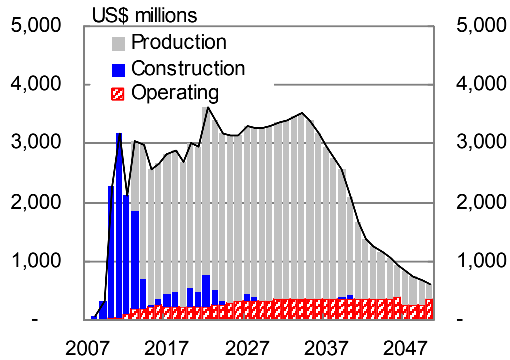
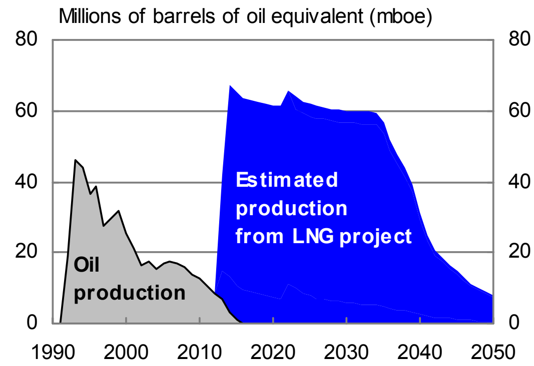


Figure 17: Oil and gas production in PNG



Source: Department of Treasury

Once the project enters into the production phase, it is anticipated that operating expenditure will average around US$260 million per annum over the life of the project. Of this, approximately US$40 million will go towards labour costs, and the remaining US$210 million towards non-labour costs.

The direct impact of the LNG Project on the PNG economy

While the LNG project will be the largest and most expensive investment in PNG to date, the extent of the impact on Gross Domestic Product (GDP) depends on how much of the economic activity actually occurs in PNG. Because much of the project construction will take place offshore, this part of the project will not add significantly to the size of the domestic economy (Figure 18).

The construction phase of the project covers field development, pipeline and LNG liquefaction plant, storage and load out. In this phase, it is assumed that all of the capital expenditure occurs offshore, and 90 per cent of the labour costs will be for expatriates, with 10 per cent for domestic labour. While the overall construction cost of the project will see direct activity of US$10 billion, only about 5 per cent, or around US$500 million can be expected to directly affect the PNG economy over the construction period.

Similarly, much of the annual operating expenditure will be sourced from offshore, with all of the non-labour costs imported, and an average of around 15 per cent of the labour costs relating to expatriate labour. The domestic share of economic activity relating to operations and maintenance is estimated at around 20 per cent, translating to around US$40 million per year.

In all, the direct economic impact on GDP in PNG is expected to be relatively small during the construction phase, averaging around K180 million annually, or around 0.8 per cent of GDP. This is because most of the expenditure will take place offshore, or will be paid to expatriate labour, who are assumed to spend only 10 per cent of their income within PNG.

Figure 18: Direct Economic Activity – Domestic vs External

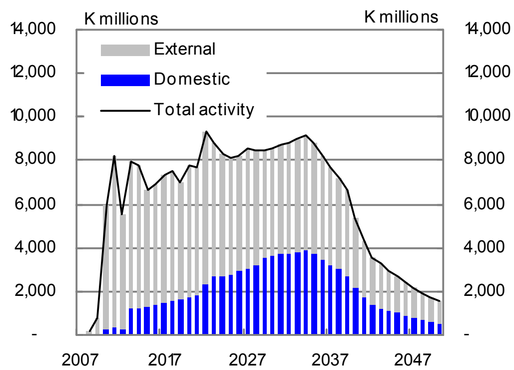
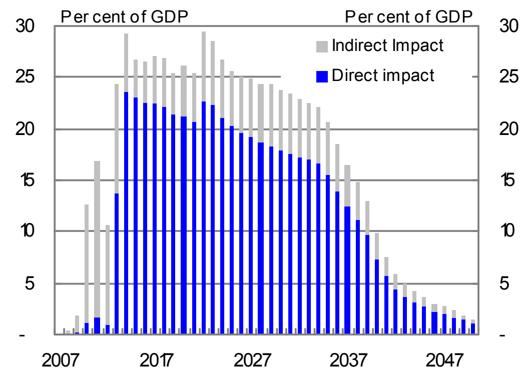


Figure 19: Direct and Indirect Impact on GDP



Source: Department of Treasury

The construction workforce is expected to peak at around 7,500 full time jobs in 2010, including direct employees, contractors, administrative and support personnel. PNG nationals are expected to make up 20 per cent (or 1,500 at peak employment) of the workforce during the initial construction period. During later construction phases, a higher proportion of the workforce is expected to be made up of PNG nationals (around 35 to 40 per cent), while during the operational phase, local employment is expected to make up between 75 and 90 per cent of the 450 to 500 positions.

The major economic impact from the LNG project will be felt once production commences in 2013 or 2014. The project is expected to produce around 61 mboe over the peak phase of the project (lasting 20 years), and an average of 46 mboe over the life of the project. Assuming oil prices of US$65per barrel (in real terms) throughout the life of the project, average annual export revenues are estimated at around US$3 billion during peak production phase, and US$2.4 billion over life of the project. This will provide a very large boost to GDP.

Once production begins, the direct impact on GDP will be very large, as all of the value added from the project is recorded as taking place in PNG. Over the length of the project, annual gross value added is estimated to average at around K5 billion. Over the peak production phase, this represents an additional 15 to 20 per cent of GDP per year, although the relative impact is expected to decline over time as the economy increases in size and as production declines towards the end of the project's life.

However, when estimating the economic impact of major investment projects in PNG, it is important to draw the distinction between production and income. This is because most of the gross operating surplus will be repatriated offshore, in the form of dividends or interest repayments on debt. These income outflows will not have any major economic impact within PNG.

While the impact of the project on GDP will be substantial, the impact of Gross National Income (GNI), which is equal to GDP plus income inflows from overseas less income outflows offshore, will be significantly less.

Once the income outflows are accounted for, the direct economic impact of the LNG project on the domestic economy is estimated to average around K2 billion per year over the life of the project (Chart 19). This will include tax payments, which make up the bulk of the impact,

dividend payments to the State, royalty and Development levy payments to landowners and Provinces, as well as income earned by local employees and contractors.

Over the first decade of production, this impact will be depressed due to allowable capital expenditure write downs (which will reduce company tax receipts) and elevated interest expense (which will reduce both tax and dividend flows). Once full company tax and dividend flows begin to be received, the direct impact is expected to increase, to around K3½ billion per year, before declining in line with lower production levels towards the end of the project's life.

The Indirect Impact on the PNG Economy

To estimate the indirect impact of the project on economic activity in PNG, through higher government expenditure, domestic expenditure by expatriate employees and increased business and consumption activity, the same methodology as ACIL Tasman has been used. Applying a multiplier of 0.7 to the direct impact on GNI provides an estimate of around K1 to 2 billion annually of additional activity over the life of the project. In addition, during the construction period, when there are large numbers of expatriate employees working in PNG, their local expenditure (assumed at 10 per cent of their incomes) is anticipated to add indirect activity – in the range of K2 to 3 billion during peak construction.

These indirect impacts are likely to come from a number of sources, including increased business activity from local companies that supply goods and services to the mining project and its employees, increased activity relating to higher Government expenditures, as well as increased domestic activity from unrelated activities, such as agriculture, that become viable due to potential improvements to infrastructure.

The total economic impact of the LNG project on the PNG economy combines the direct and indirect impacts. The total impact on GDP is estimated to average around K9 billion over the peak production phase of the project, and average around K7 billion per annum over the life of the project. This represents around a 25 to 30 per cent increase in GDP during the peak production phase, and around 15 to 20 per cent increase in GDP over the life of the project (Figure 19). The total impact of the project on GNI, which provides a more representative picture of the economic impact of the project, once overseas income flows are removed, is around K3½ billion per annum, or 9 per cent of GNI (Figure 20).

Figure 20: Total Direct and Indirect Impact on GNI

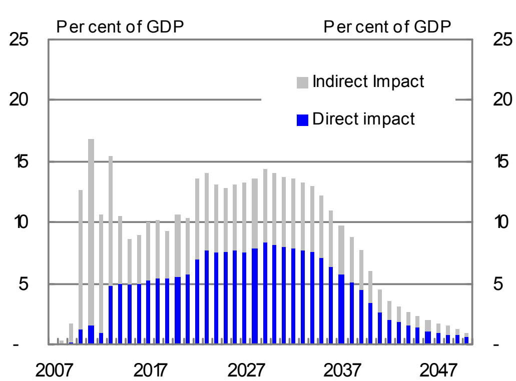
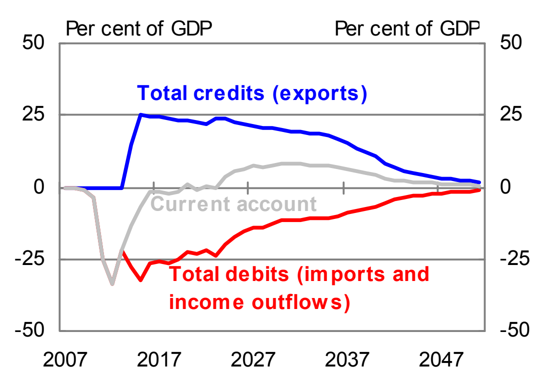


Figure 21: Impact on the Current Account Balance



Source: Department of Treasury

These estimates are broadly in line with ACIL Tasman estimates which were developed using the same approach, using information provided by Exxon Mobil about construction and operation expenditures, production revenues and domestic and expatriate employment to estimate the direct and indirect economic impact of the project on the PNG economy.

On the other hand, these estimates are significantly different from the more publicised ACIL Tasman estimate of the impact of the project doubling real GDP in PNG. This estimate was derived through running a shock through a CGE model. While this approach is useful for estimating the impact of the project on various industry sectors, as ACIL Tasman made clear in their analysis, it should not be interpreted as a forecast or an accurate estimate of the size of economic impacts.

The impact on the Balance of Payments

The LNG project is also anticipated to have an extremely large impact on PNG's Balance of Payments. During the initial construction phase, large amounts of imports can be expected to result in exceptionally large current account deficits. Once construction is completed, and production begins, the increase in exports are expected to moved the current account into surplus, although this will be offset by increased income outflows, as interest and dividend payments flow offshore.

The majority of construction activity is anticipated to be imported directly from overseas, or built and assembled within PNG by foreign residents on short term visits into the country. The construction materials, worth approximately K17 billion, will be recorded as imports of capital goods, while payments to expatriate employees temporarily residing in PNG, worth approximately K13 billion over the construction phase, will be recorded as service imports. These imports will result in a large current account deficit.

This construction activity will be financed by a mixture of Foreign Direct Investment and debt. This will be recorded as inflows in the capital and financial accounts, resulting in a capital account surplus which finances the current account deficit.

As the project moves into the production phase, exports of LNG, condensate and LPG are expected to be worth K6 to 8 billion annually. Partially offsetting this will be imports of goods and services of around K500 to 700 million per annum, resulting in a large trade surplus.

However, there will also be significant income outflows, in the form of interest expenses, dividend payments, recorded depreciation and reinvested income (if the profits are not paid out as dividends). This will result in a large income deficit, which will initially offset the trade surplus coming from LNG exports, before declining once taxable depreciation write offs and elevated interest expense (which are recorded as income outflows) end approximately 10 years after production begins.

The net result is a large current account deficit during the construction phase, current account balance during the period that financing and depreciation costs are elevated, followed by large current account surpluses once export earnings are greater than foreign income outflows (Figure 21).

If the LNG project proceeds, it can be expected to have a large and enduring benefit on the PNG economy.

8.5 PRICES

Annual inflation as measured by the consumer price index (CPI) is projected to be 6.1 per cent in 2009, down from the expected 2008 outcome of 10.6 per cent. This moderation in inflation is due to the reversal of international inflationary pressures and the sharp appreciation of the Kina.

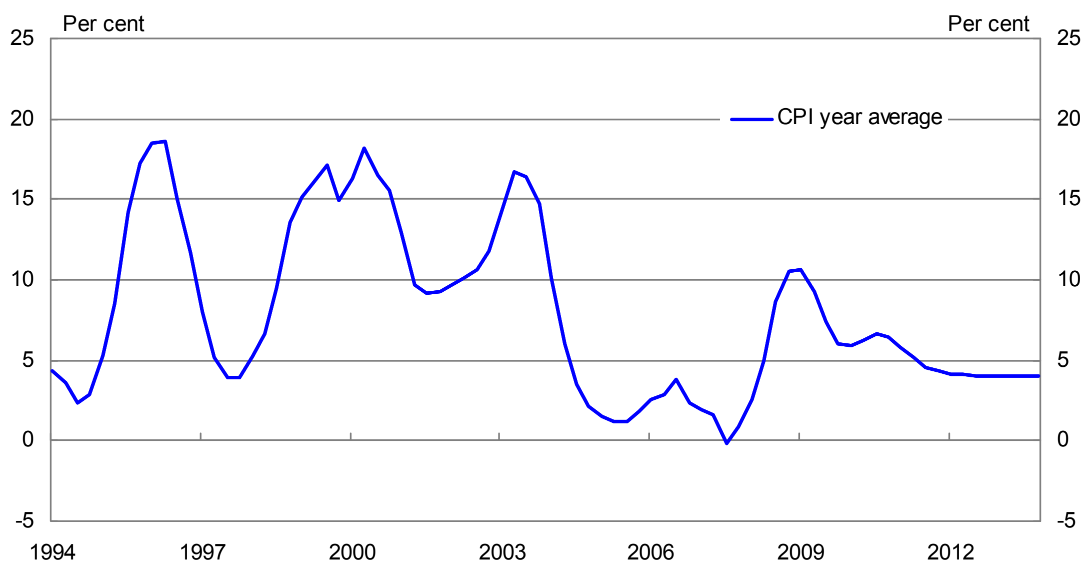
This outlook does not reflect the easing of domestic inflationary pressures, as many of the factors, including strong domestic growth, increased Government expenditure, relatively loose monetary conditions, increasing wage pressures and increasing evidence of capacity constraints have continued to build.

The terms of trade shock, which has imparted significant external stimulus into the economy, has reversed recently. However, by saving the windfall revenue in trust and repaying debt, the Government has shielded the economy from the full brunt of the impact of the commodity price boom, by saving part of the windfall revenue in trust. This means that the impact will continue to be felt into the future as the Government gradually spends the trust money. The Government will need to be careful to limit the drawdowns to a rate that the domestic economy can readily absorb, without igniting further inflationary pressure.

Over the medium term, annual average inflation is expected to return to the 3 to 4 per cent range, on the assumption of continue prudent operation of fiscal and monetary policies, and that the current episode of high inflation is not built into expectations.

The way in which the Government manages the trust funds represents one of the major risks to the inflation over the medium term. Other risks include sharp movements in the exchange rate, and the potential for a break out in wage pressures, which could risk a wage price spiral. The outcome of the Minimum Wages Board will also be an important factor determining wages, as will the outcome of future public service pay negotiations.

Figure 22: Inflation Outcome and projections (1995 – 2013)



Source: Department of Treasury, NSO

8.6 EMPLOYMENT AND WAGES

Employment levels have increased significantly over recent years, and are expected to continue to grow in 2009 in line with ongoing above-trend economic growth.

Sustainable strong employment growth is expected from the mineral sector, especially from the new mining projects. Employment growth in the non-mineral sectors is expected to come from building and construction, manufacturing, finance, real estate and business services, retail and agriculture, forestry and fisheries sectors, supported by strong non-mineral GDP growth.

Government spending is expected to further boost economic activity and employment growth in the medium term.

In 2009, the public sector wage agreements for 2007 to 2009 is expected to be fully implemented and the benefit of the remuneration structure and pay provide scope for better productivity and performance to be achieved.

A teachers' wage agreement for the period 2007 to 2010 was finalized in November 2008. The agreement provides for increases to teachers salaries as well as automation of progression under the Teachers' Performance Based Salary Scheme. The wage increases are affordable and and should not add to inflationary pressure over the life of the agreement.

In 2008, the Government re-established the Minimum Wages Board (MWB). Hearings are still underway, however in making recommendations to Government, the MWB needs to be mindful of the economic impact of any increase in minimum wages, particularly any adverse effects on inflation, employment and PNG's international competitiveness.

8.7 BALANCE OF PAYMENTS

After a number of years of large current account surpluses, caused by record high commodity prices, and correspondingly high export values, the balance of payments are expected to turn around dramatically in 2009 and beyond. This assessment does not include the impacts of the proposed LNG project, although project's implications on the Balance of Payments is discussed in Section 8.4.

The large falls in commodity prices are resulting in a significant reduction in export values. This will reduce the trade surplus substantially, and is likely to move the current account into a deficit position. Combined with this, high levels of imports are expected in 2009, due to continued strong domestic growth, and large capital imports associated with the Ramu Nickel project.

The net result is a large expected current account deficit of K1.6 billion, or 7.5 per cent of GDP in 2009. This is a very large swing from the expected current account surplus of K1.9 billion, or 8.7 per cent of GDP in 2008.

The large build up of foreign exchange reserves by the Bank of PNG is not expected to continue into the future, due to the expected decline in Mining and Petroleum Tax revenues. The bulk of the current account deficit is anticipated to be financed on the capital account side through continued foreign direct investment, both in mining projects, such as Ramu Nickel and non-mineral enterprises.

Over the medium term, it is anticipated that export values will gradually decline, due to a further projected fall in commodity prices, which are assumed to return to 10 year averages

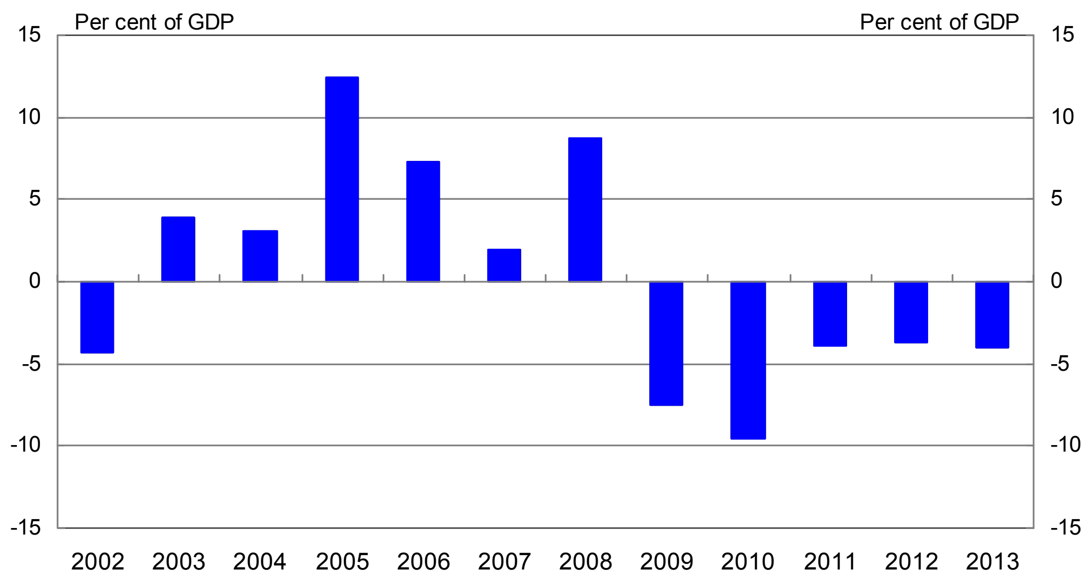
over the outyears, and continued reductions in oil exports as existing fields mature. This is expected to be partially offset by increased export volumes in other areas, including some agricultural commodities like palm and copra oil, as well as the commencement of nickel and cobalt exports from Ramu Nickel.

It is anticipated that general merchandise imports will fall, as the economy adjusts to lower export revenues in coming years, and as construction of the Ramu Nickel project reaches completion in 2010. Service imports are expected to remain relatively stable over the outyears.

The income deficit is anticipated to decline over the medium term, due largely to an expected fall in mineral dividends, as mining profits shrink in line with falling commodity prices. Transfer inflows are expected to fall in 2009, due to the appreciation of the Kina, and then remain relatively constant through the outyears.

Over the medium term, the current account is expected to remain in deficit, in line with lower commodity prices and export values, and elevated import levels. This indicates that adjustments will be required in order for the external accounts to move into a sustainable position.

Figure 23: Current Account Balance (Per cent of GDP))



Source: BPNG, 2005-2007, Treasury Dept 2008-2013

8.8 MONETARY POLICY

Monetary Policy formulation and implementation is the responsibility of the independent Bank of PNG.

Monetary conditions have been relatively loose in the last three years. The Bank of PNG has started to react to increased inflationary pressures in 2008, by increasing official interest rates and the Kina has appreciated. The Kina Facility Rate which is the benchmark interest rate has been increased by a total of 100 basis points in 2008, increasing from 6 per cent to 7 per cent. This is aimed at slowing the economy thus reducing inflationary pressures.

There has also been an appreciation of the Kina – gradually against the United States Dollar (USD) and more sharply against the Australian Dollar (AUD). This is expected to stem some of the inflationary pressures in the economy.

Despite this, key monetary aggregates are still growing at worrying high rates – money supply and credit are up over 30 and 40 per cent respectively in the year to September 2008. With higher inflation outcomes in 2008, real interest rates are also well into negative territory, proving very accommodative for further private sector investment. This will add to aggregate demand and build pressure on prices.

Monetary policy is the key tool in preventing further inflation, and it needs to be closely monitored and adjusted to reflect current and future circumstances. A coherent policy approach between monetary and fiscal policies is vital for macroeconomic stability to be maintained and the good economic outcomes recorded in recent times to be protected.

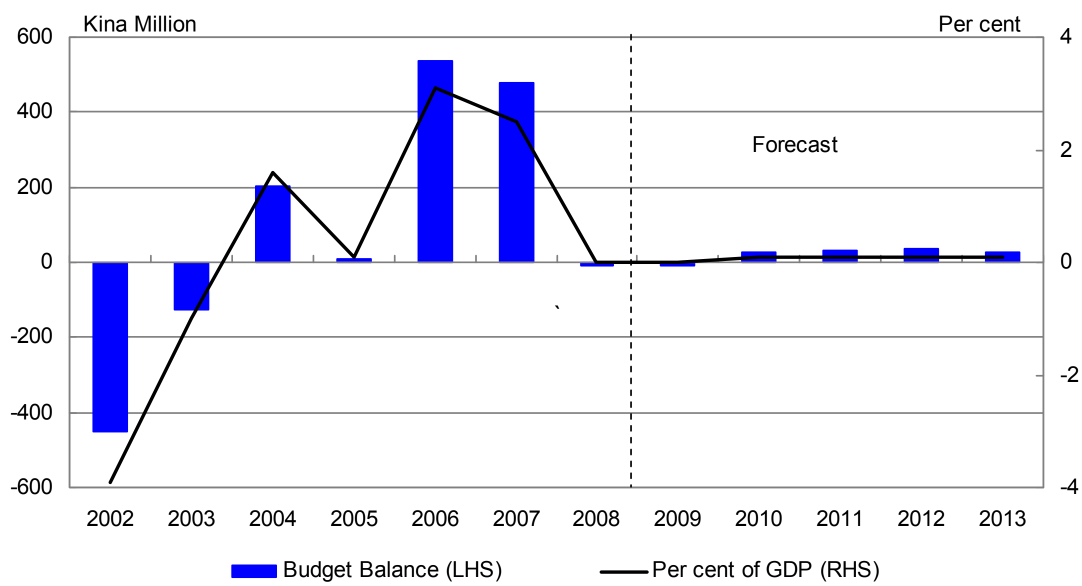
8.9 MEDIUM TERM FISCAL OUTLOOK

8.9.1 Overview

The medium term outlook has been prepared in the context of the 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 price boom) over the forecast period. This is based on conservative and achievable estimates for economic growth and revenues.

Over the medium term, prudent management of expenditure framed up against the new MTFS should hold government expenditure in a sustainable position, in spite of the large projected declines in revenue due to the sharp declines in commodity prices. This will allow for balanced budgets into the out years, as long as expenditure control is maintained.

Figure 24: Medium Term Fiscal Outlook

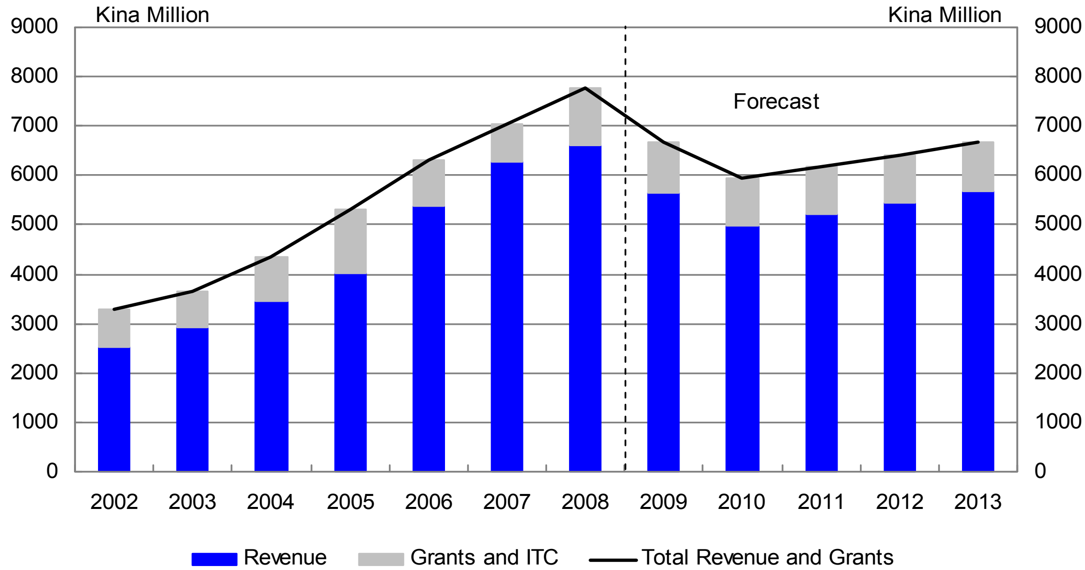


Source: Department of Treasury

8.9.2 Revenue and Grants

Total Revenue and Grants are expected to decline from their peak in 2008. This reflects the sharp fall in tax revenues in 2009, due to the large falls in commodity prices, as well as a fall in the Kina value of project grants, due to the appreciation of the exchange rate, particularly against the Australian Dollar. Following the fall in 2009, Total Revenue and Grants are anticipated to increase gradually, in line with the trend increase in economic activity.

Figure 25: Total revenue and Grants 2002 – 2013 (Kina Millions)



Source: Department of Treasury

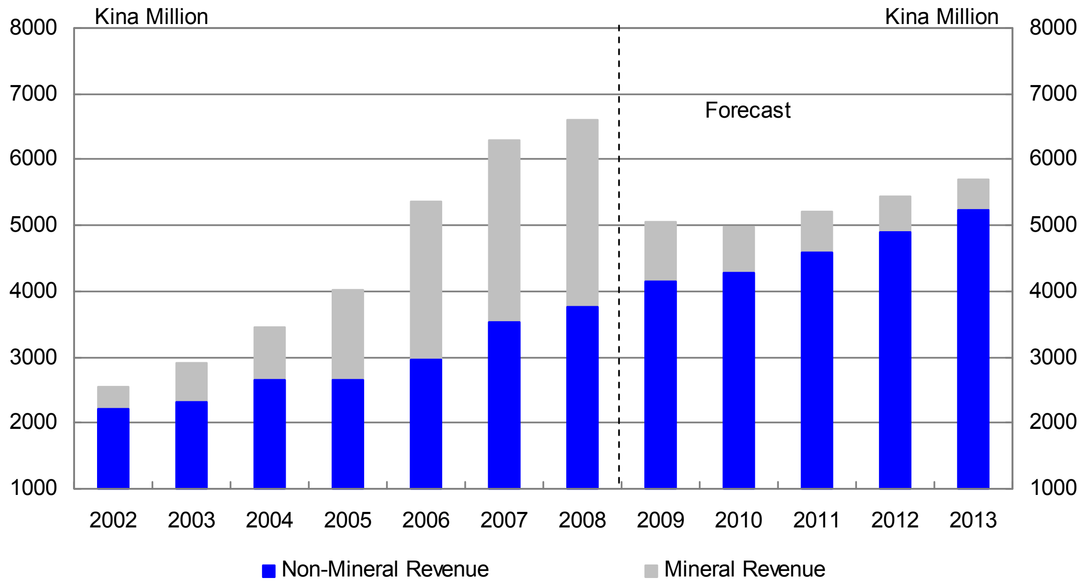
8.9.2.1 Revenue

Total revenue is projected to decline from K6,595.5 million (30.6 per cent of GDP) in 2008 to K5,694.9 million (21.6 per cent of GDP) in 2013. This is due to a sharp drop in mineral revenue in 2009, in line with significantly lower commodity prices and mining and petroleum tax receipts. Over the medium term, mineral revenues are expected to decline more gradually, in line with the maturation of existing oil fields, which will result in lower oil production.

In 2009, revenues are expected to be elevated by a one-off K600 million injection of funds from the Gas Commercialisation Equity Financing trust account. This is a temporary measure, used to fund one-off expenditures, such as DSIP, in 2009. Revenues will fall sharply in 2010, as this measure is not anticipated to be replicated.

The decline in mineral revenues in the out years is expected to be offset by increases in non-mineral revenues as non-mining activity continues to grow, generating increased employment and profits and providing for increased income, company and activity based tax collections.

Figure 26: Mineral and Non-Mineral Revenue



Source: Department of Treasury

8.9.2.2 Tax Revenue

Tax revenue is projected to fall from K6,116.2 million in 2008 to K5,415.5 million in 2013. Mining and Petroleum Taxes – the biggest component of tax revenues is projected to decline from K2,392.2 million in 2008 to K227.4 million in 2013. This is a massive fall and is due to the projected decline in commodity prices – with commodity prices expected to return to more normal levels over the medium term. In addition, the decline in production from existing oil fields is expected over the medium term and new mining projects, such as Ramu Nickel coming on stream but not immediately paying tax.

8.9.2.2.1 Non-Tax Revenue

Non-Tax revenue is projected to decline from K479.3 million in 2008 to K279.4 million in 2013. The major cause of the decline is lower dividend payments from Ok Tedi due projected decline in the price of copper to long-run averages. Dividend payments from other State assets, such as IPBC, the Bank of PNG and National Fisheries Authority are expected to decline to long run averages in the outyears, while Departmental non-tax revenues are expected to increase in line with economic growth. The injection of funds from trust accounts will provide a one-off boost to non-tax revenue in 2009, which will not be continued in the medium term, resulting in a sharp drop in 2010.

8.9.2.3 Grants

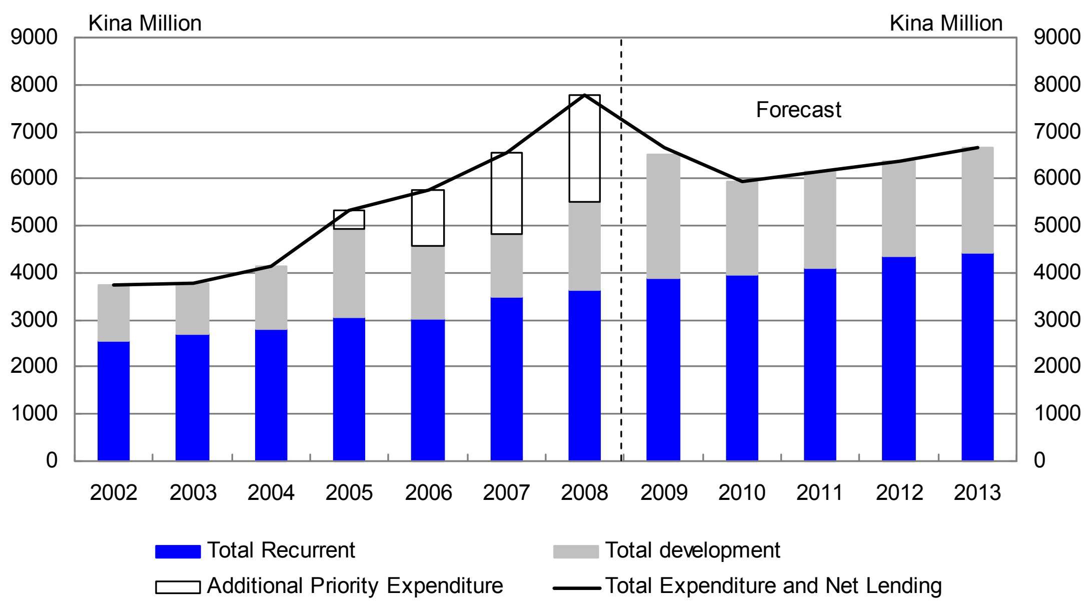
Grants are provided at the discretion of donors. The appreciation of the Kina against most of the donor currencies – especially the Australian dollar in 2008 has reduced the Kina value of grants significantly. This is also going to be the case for grants in 2009 and 2010 which have also been converted using higher exchange rate assumptions. In the intervening years (2011-2013), grants have been held consistent with what is expected in 2010 due to limited information available from donors.

8.9.3 Expenditure and Net Lending

Total Expenditure is expected to decline from K7,789.9 million (36.1 per cent of GDP) in 2008 to K6,646.7 million (25.3 per cent of GDP) in 2013. This decline is because under current projections, there is no room for Additional Priority Expenditures in the medium term.

However, there will be some one-off expenditures included within the Development Budget in 2009, which are funded through the injection of funds from the Gas Commercialisation Equity Financing trust account. The remaining funds from the trust account will be reappropriated back into the trust account, to be used for LNG project equity and sunk project costs.

Figure 27: Total Expenditure and Net Lending 2002 – 2013 (Kina Millions)



Source: Department of Treasury

8.9.3.1 Recurrent Expenditure

Total recurrent expenditure is projected to increase from K3,639.3 million (16.9 per cent of GDP) in 2008 to K4,438.0 million (16.9 per cent of GDP) in 2013.

Total Government personal emoluments expenditure is projected to increase by an annual rate of 3.8 per cent over the medium term, from K1,546.9 million in 2008 to K1,952.5 million in 2013. This reflects expected public servant pay increases, including increment advancement and provisions for superannuation. The reduction in superannuation provisions fails to meet the Government's commitment to fully fund employer superannuation contributions for public servants, and will result in an increase in superannuation liabilities in 2009, although the provision is assumed to be fully funded in the outyears.

The combination of pay increases and increment advancement means that, even with staffing levels remaining at current levels, personal emoluments are expected to continue to increase.

Goods and Services Expenditure by National Departments is projected to increase from K1,330.4 million in 2008 to K1,456.6 million in 2013. This increase reflects indexation for anticipated general price increases, allowances for anticipated future expenditures, such as the 2012 election, and some unallocated expenditure from funds which are projected to be available in the forecast period, which may be used for recurrent expenditure, based on the Medium Term Fiscal Strategy.

Legislation implementing the Review of Intergovernmental Financing Arrangements (RIGFA) was passed by Parliament in 2008, and is now being used to calculate the cost of goods and services grants for Provinces and Local-Level Governments. The new system will see goods and services funding for Provinces and Local-Level Governments increasing from K126.8 million in 2008 to K291.2 million in 2013.

Transfers to Statutory Institutions are projected to increase by the estimated inflation rate over the medium term.

Interest payments and fees on existing debt are projected to increase moderately over the medium term, reflecting the continued 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.

8.9.3.2 Development Budget

Domestic Funds for the Development Budget increases significantly in 2009, due to a large number of one-off expenditures, largely funded through one off revenue injections from trust accounts in 2009. These one-off expenditures are not built into the medium term projections, resulting in a return to more normal expenditure levels in 2010. Over the medium term, domestic funds for development expenditure are projected to grow in line with inflation, and in line with the Government's strategy of increasing the Development Budget, and also include the bulk of unallocated expenditures from funds which are projected to be available over the medium-term.

8.9.3.3 Additional Priority Expenditure

Due to the assumed decline in commodity prices back to long-run levels, there is not anticipated to be any Additional Mineral Revenues or Additional Priority Expenditure over the medium term.

However, given the uncertainty surrounding the projections, commodity prices could return to above long-run average levels. If this does eventuate, and additional mineral revenues become available, they will be allocated according to the Medium Term Fiscal Strategy, with 70 per cent being directed toward pre-funding public investments, and 30 per cent used to repay public debt and liabilities. The use of Additional Mineral Revenue should:

- Benefit future generations
- Be flexible, in case the additional revenues do not materialize
- Be made while considering the impact on domestic and import demand and
- Be compared to and assessed against all other potential investment projects.

8.9.4 Financing

The medium term outlook is consistent with the new MTFS. As a result, financing requirements are expected to be manageable over the medium term with expected small surpluses to be used for debt repayment.

8.9.5 Public Debt

Public debt is projected to decline marginally over the medium term, in line with small Budget surpluses. Combined with continued economic growth, this is expected to result in continued reductions in the debt to GDP ratio.

CHAPTER 9. MEDIUM TERM FISCAL STRATEGY

9.1 OVERVIEW

The new Medium Term Fiscal Strategy (MTFS) for 2008-2012, was endorsed by the Government in mid 2008. The strategy was put together after thorough consultation with stakeholders inside and outside the Government, including PNG's development partners.

The MTFS is used as the main guiding framework for the 2009 Budget. This chapter contains a summary of the Strategy.

9.2 RATIONALE

The rationale of this strategy is:

- 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);

- to develop further the strategy followed in 2002-2007 for handling varying, volatile and highly uncertain amounts of additional revenue from PNG's commodity exports; and

- 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 new MTFS includes –

- a rule for how much of the expected mineral revenue is reliable enough to fund ongoing spending;

- principles for allocating any additional mineral revenue, whenever it is received, to the best uses for improving PNG's long-term future;

- principles concerning how quickly additional mineral revenues should be spent in order to avoid destabilizing swings in Government expenditures; and

- an approach to funding major State investment projects, and flexibility for dealing with changing circumstances, such as a different outlook for commodity prices, during the next five years.

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.

Commodity prices are highly volatile and no one can confidently predict which way they will move. While there is a possibility of mineral revenue coming in much stronger than projected – as has been the case over recent years – there is also a possibility that prices could fall sharply, and revenue could come in much lower than projected. The recent decline in commodity prices is an example of this.

In formulating the new MTFS, a key step has been to define 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 combined with non-mineral revenue and allocated for spending in the recurrent and development budgets. This should provide for sustainable growth in ongoing Government expenditure that is broadly linked to economic growth and that does not have to be slashed if commodity prices return to long-term values.

Therefore, the rule in this strategy is that **mineral revenue equal to 4% of GDP will be included in funding of ongoing spending**. The remainder of mineral revenue is to be regarded as additional revenue, to be allocated in ways which can be adjusted, with minimal disruption, when the amounts received vary from their forecasts and fluctuate from year to year.

The 4% 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, ongoing spending plans would be cut, or a temporary Budget deficit would be necessary, or both.

9.5 IMPLICATIONS FOR ONGOING EXPENDITURE

Ongoing spending is constituted by the recurrent and development budgets (in this context the part of development spending funded by the Government's resources including borrowing, but excluding the part of development spending funded by grants from development partners). The main implications of the strategy for ongoing spending are –

- that the amounts of ongoing spending will be fairly stable from year to year; and
- that if forecast ongoing expenditure is less than the sum of normal mineral revenue and non-mineral revenue – what can be called total normal revenue – then ongoing expenditure could be increased up to that sum, while staying within a prudent fiscal framework.

In 2009 revenue is expected to decline significantly due to lower commodity prices and the natural decline of oil production as reserves are run down. However, ongoing spending for 2009 has not changed substantially from the 2009 Budget Strategy. This is because non-mineral revenue growth is still strong. According to the MTFS, ongoing expenditure is kept in line with normal revenue - revenues that can be expected in the absence of a commodity price boom.

It is a crucial part 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.

9.6 PRINCIPLES FOR ALLOCATION OF ADDITIONAL REVENUE

There are four key principles which apply to the choice of ways in which mineral revenue above the 4% of GDP threshold — referred to here as additional mineral revenue — 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 for investments, preferably in line with the MTDS priorities, that will benefit future generations as well as this one.

This is the principle of fairness, as stated in the Constitution's National Goals: "*safeguard the national wealth, resources and environment in the interests of not only the present generations but also future generations".*

Unless this principle is followed, future generations will be left poorer when PNG's mineral resources are used up.

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.

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 Government 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:

- adding to the funds held in trust for additional public investments over the medium term; and
- repayment of public debt.

9.7 PREFERRED AREAS FOR ALLOCATION OF ADDITIONAL REVENUE

Additional Public Investments

In order for public money to be well spent, every prospective investment must be carefully assessed:

- **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.

These assessments represent hard tests.

The average cost of interest on domestic public debt can be regarded as a threshold rate, which must be exceeded by the risk-weighted expected net benefit from an investment project in order to justify allocating additional revenue to that project.

Very large prospective investments, such as State equity stakes in gas commercialization or other resource development projects, should be assessed in the way just described if they are candidates for funding from State revenue or borrowing. But their size introduces some added factors –

- assessing them may be a complex task for which specialist advisers are needed;
- they may need funding from more than one year's additional revenue; and
- the concentration of risks in the State's financial outlook associated with them 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.

Pre-funding of spending which is ongoing in its nature, such as rehabilitation and maintenance of public infrastructure, can be regarded as part of this category. This has been one of the main uses to which "windfall" revenue was allocated in supplementary budgets in 2006, 2007 and 2008.

Repayment of public debt

This is the other option for use of additional revenue. The advantages of repaying public debt are as follows.

- It would have an immediate positive effect on the spending side of the Budget, continuing every year, as resources are freed from debt servicing.
- Debt repayment strengthens the Government's financial position or "balance sheet", which increases investors' confidence and helps to lower interest rates. This reduces borrowing costs for PNG households and businesses.
- 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.
- In a higher inflationary environment, the repayment of debt does not directly add to demand pressures like additional Government spending.

Apart from public debt, there are **other State liabilities** which should be similarly repaid or reduced. 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. But there are two necessary conditions for including the reduction of these liabilities in uses of additional revenue –

- different State liabilities have associated with them different types of risks, related to trends in the economy or to other more specific factors, and these risks should be assessed in comparing the benefit of reducing the liability to Nambawan or other liabilities with the benefit of repaying public debt; and

- it would be harmful to the public interest to reduce the disincentives for fraudulent or unnecessary acceptance of claims, and that could be the effect of specially paying out such liabilities as court orders and payment arrears.

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. It will depend on what feedback the Government is getting from implementation efforts. It will also depend on the state of the economy, especially if demand is already growing strongly and there are inflationary pressures which additional public investments would worsen.

A starting-point for the budgeting process, this strategy contains a 70:30 guideline — **70% to pre-fund future additional public investments and 30% repayment of public debt.** The reason for this guideline is the desirability of ending the MTFS period with a lower level of public debt, and correspondingly stronger State finances.

9.8 IMPLICATION FOR OVERALL BUDGET BALANCE & PUBLIC DEBT

The overall (or "headline") balance in each year's Budget will depend on –

- whether ongoing spending is kept within the limit of total normal revenue; and

- how additional mineral revenue is allocated and appropriated between public investments and debt repayment — since appropriations for public investments are recorded in the Budget as "above the line" spending, while debt repayment is not.

The overall balance in each year's Budget *will not* be affected by the amount drawn down from the trust accounts for actual public investment expenditure, as for budgetary purposes, the expenditure is recorded once the funds are transferred to trust.[3]

---

[3] This differs from the IMF definition of the Budget balance, which records the expenditure only once it has been drawn down from the trust account and actually spent.

Nonetheless, it is important to consider the expected rate of drawdown while framing the Budget, in order to contain inflationary and other demand pressures.

9.9 DEMAND MANAGEMENT

A major consideration for fiscal policy is the impact that Government spending has on aggregate demand in the economy. Too much Government spending over a given period of time can cause excess demand, resulting in sharply higher inflation and interest rates, a surge in imports and crowding out of private sector investment. This has been a major problem for PNG on numerous occasions in the past.

A rapid drawdown of funds held in trust could contribute to higher inflation, which is why the MTFS limits actual government expenditure from additional mineral revenue to a maximum of 4 per cent of GDP per annum. In order to adhere to this rule, the Government will improve efforts to closely monitor and control spending from trust funds.

9.10 PREPARING FOR LONG-TERM CHALLENGES

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 may not be contained for some time. It is likely to cause large and mounting costs, not only for people directly affected by illness and deaths but also for the public health system, for many types of private businesses, and for the State as an employer; and

- further in the future but already in sight is the prospect of having to adapt to **climate change** — affecting 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.

9.11 FUNDING OF INVESTMENT PROJECTS

Funding for investment projects can come both from the Budget and from additional State borrowing. However, 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 70:30 guideline could be over-ridden and the forecast additional mineral revenue in 2009-2012 could be used for public investments.

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.

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.

9.12 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 and Context

The objective of the Medium Term Debt Strategy 2009–2013 (the Debt Strategy) is to minimize the cost of debt consistent with the Government's tolerance for financial risk. There are three major strategies: reduce debt to sustainable levels; change the composition of the debt portfolio so as to reduce financial risk to prudent levels; and develop the domestic debt market.

The Debt Strategy covers debt issued by the State and secured by a claim against consolidated revenue, and excludes unfunded superannuation, the debt of State Owned Enterprises and other contingent exposures.

Over the last five years, the Government has made excellent progress in implementing the Debt Strategy. However, as outlined later in Section 8.1.3, there are significant changes and new threats which the 2009-2013 Debt Strategy must address.

10.1.2 The Updated Debt Strategy

The Debt Strategy has been updated for the financial and macroeconomic forecasts in the 2009 Budget and Medium Term Fiscal Strategy (2008-2012). There are also several new issues that the updated Debt Strategy will address:

- The impact of the international financial crisis on the Debt Strategy
- The likely increase in debt or contingent liabilities of the State due to the Government's plan to borrow money to invest US$1 billion in the equity of the LNG Joint Venture
- The large amounts of cash kept in Trust Accounts
- The circumvention of budget and debt controls by proponents of public-sector capital expenditure funded by foreign-currency debt
- The over-reliance on domestic investors, as no foreign investors currently own Kina-denominated Government securities
- Treasury's support for introducing an Asset Liability Management framework to better manage the State's financial assets, liabilities and off-balance sheet exposure
- The role and contribution of Petromin and IPBC
- BPNG's reform on the national payments system, and the independent reviews of the PNG's Financial Sector by the IMF and the State's debt strategy in 2009

As noted in previous years, the Government's current debt portfolio is significantly different from the norms of a prudent debt portfolio. This imbalance makes the strategy choices clear: reduce debt to prudent levels, while reducing the reliance on risky debt (foreign-currency, short-term or complex debt) and increasing the reliance on low risk debt (long-term fixed-rate Kina denominated debt and simple debt securities).

There is strong support by the domestic financial institutions, international financial institutions and other investors for the Debt Strategy.

10.2 REDUCING DEBT TO SUSTAINABLE LEVELS

The most widely accepted and used measure of debt sustainability for a State is its sovereign credit rating. The State's foreign-currency debt has a B plus or highly speculative rating, while domestic debt has BB minus or speculative rating. The rating agencies use an economic measure of indebtedness and consider that the State has a contingent liability for a debt issued by State entities. The IMF and World Bank also have a narrower definition of debt sustainability and their indicators show that current levels of debt are almost sustainable.

PNG's debt sustainability can be improved through four major means: the growth in the economy, improvements in public-sector management and governance, the reduction in public debt and other liabilities, and reducing reliance on high–risk, complex debt and increasing reliance on low-risk, simple debt securities.

Two factors will improve debt sustainability and the State's rating: the economy is forecast to continue to grow at a moderate level, and there are plans to improve the governance of public entities.

In particular, Treasury has initiated and will lead a whole-of-government balance sheet committee to clarify the roles and improve coordination of the various State entities responsible for managing the State's financial assets, liabilities and off-balance sheet exposures. Treasury will assist the committee to establish a method to recognise and measure the economic and risk exposures of these entities. Such measures will assist the State to set an overall limit for debt and other financial obligations for all State entities, and then to apportion individual limits for debt and other financial obligations amongst State entities. Another improvement in governance that the Department of Treasury will initiate is to work with other State entities so there are effective and agreed procedures and controls on the evaluation, selection and funding of capital expenditure.

Another significant change that may influence debt sustainability of the State is the Government's decision that IPBC will borrow to fund the Government's US$1 billion investment in the equity of the LNG Joint Venture. The Rating Agencies' and IMF will independently assess the impact of the above changes on the debt sustainability and credit rating of the State.

10.3 REDUCING FINANCIAL RISKS

10.3.1 Introduction

Treasury's own analysis demonstrates that the cost of debt is minimised and risk of debt kept at tolerable levels through competitive auction of simple financial securities denominated in Kina, and borrowing limited amounts of highly concessional debt from international financial institutions or other development partners. Treasury's analysis also indicates that complex financial instruments and opaque off-balance sheet structures are inappropriate for PNG due to lack of skills and systems to manage the risks successfully, and risk appetite to absorb losses.

The international financial crisis has provided strong support for Treasury's "keep it simple strategy". The crisis was partly due to large international financial institutions failing in a spectacular way to manage the risks of complex financial instruments and off-balance sheet structures. If these institutions have difficulty in successfully managing such financial structures, there are lessons for others to learn.

In 2008, Treasury continued to hold regular, successful monthly auctions for Inscribed Stocks (bonds) and weekly auctions of Treasury Bills as and when needed. The detailed results of the auctions are quickly displayed on Treasury's website so as to increase investors' information and confidence in the auctions.

Each year, the IMF works with Treasury to develop a set of financial scenarios relevant to PNG. The scenarios demonstrate the main risks to budget projections and relevant constraints and implications for the Debt Strategy. PNG's proposed mix of debt instruments and annual issuance plans are shown to mitigate financial risks, and keep debt costs at comparable levels to other developing countries.

The proposed whole-of-government balance sheet committee will help develop longer-term, coherent strategies for the management of the State's major financial resources and obligations, and provide a valuable forum to critique the Debt Strategy. The Memorandum of Understanding between Treasury and BPNG already provides a forum to critique the Debt Strategy and understand its implications for Monetary Policy, while the internal review process in Treasury ensures the Debt Strategy is aligned to the Fiscal and Development Strategies.

Finally, the success of the Debt Strategy depends on the support of investors, and Treasury will continue its six-monthly visits to all major investors and the publication of annual issuance plan.

10.3.2 Foreign Currency Risk

Foreign-currency debt has the highest risk-adjusted cost of debt for Papua New Guinea, with a similar average economic cost to domestic debt over the last thirty years, while the volatility of the economic cost is nearly four times greater than domestic debt and tends to exacerbate economic cycles.

The Government has three options to reduce the proportion of foreign-currency debt: (i) it can use any budget surplus and windfall revenue to retire foreign-currency debt; (ii) it can borrow domestic funds to retire foreign-currency debt; and (iii) it could use derivatives to hedge the foreign-currency exposure.

The first option uses budget surpluses and 30% of windfall revenues to retire foreign-currency debt and other financial liabilities. All foreign-currency loans have been ranked by their risk and cost to identify loans that should be retired first. This analysis is based on asset-liability management principles, and takes into account any natural hedge provided by the Government's foreign-currency assets and revenues.

The second option is also used to retire additional foreign-currency debt. Domestic funds are borrowed to retire foreign-currency debt (the amount of domestic funding is kept at levels that do not crowd out the private-sector or encourage domestic financial institutions to take excessive levels of public debt). The Government will investigate using Kina-denominated concessional debt from ADB.

The third option is not used as complex instruments are avoided for reasons outlined in previous sections.

New foreign-currency loans will still be considered if the loan is highly concessional and in a low risk currency, and if there is an overall decrease in foreign-currency debt. The criteria for

concessional financing shall be a grant element of 35 per cent or more.[4] This is in line with international debt management practice and as recommended by IMF and World Bank.

The projected decrease in foreign-currency debt, consistent with the MTFS is shown in Figure 28 on the following page.

10.3.3 Interest rate Risk

The Debt Strategy aims to increase the net amount of fixed-rate Inscribed Stocks by K1 billion over the next five years, and decrease Treasury Bills from about K1.1 billion as at the end of 2008 to about K0.7 billion in 2013.

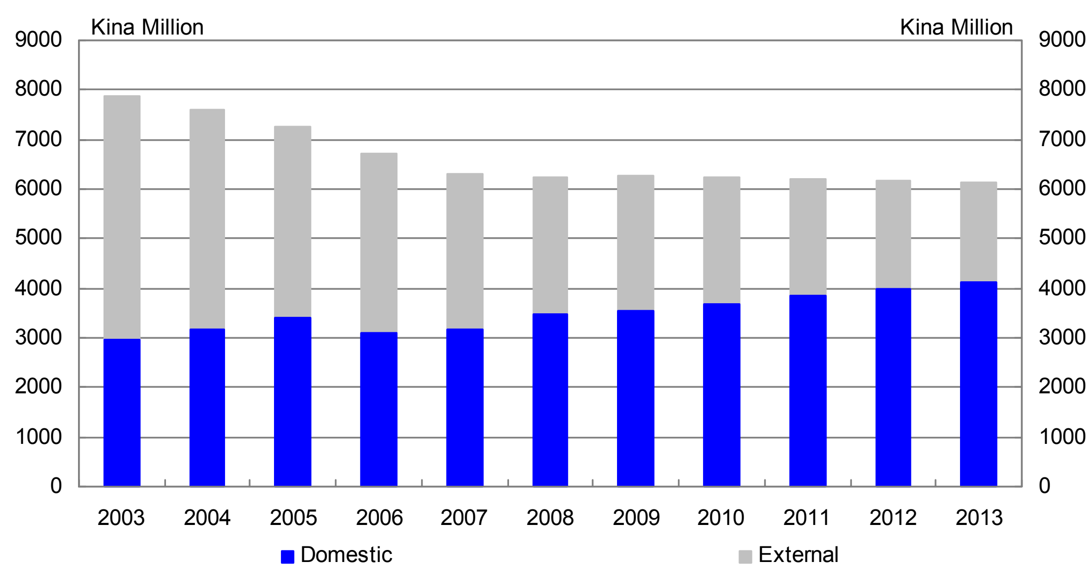
On average, emerging market countries have only 10 per cent of their domestic debt in Treasury Bills (IMF's 2007 Global Financial Stability Report Chapter III). The recent international financial crisis highlights the importance of not depending heavily on short-term debt. The 2009-2013 projections assume Treasury Bills will be between 25% and 10% of domestic debt.

Table 67: Approximate Composition of Domestic Debt by Instrument

Instrument Type	Current Range Per cent	Target Range Per cent
Treasury Bills	32	15-30
Inscribed Stocks / Other	68	70-85

Source: Department of Treasury

Figure 28: Currency Composition of Government Debt 2003-2013 (Kina Millions)



Sources: Department of Treasury

[4] The grant element is the difference between the face value and the market value of a loan expressed as a percentage of the face value of the loan.

10.3.4 Refinancing Risk

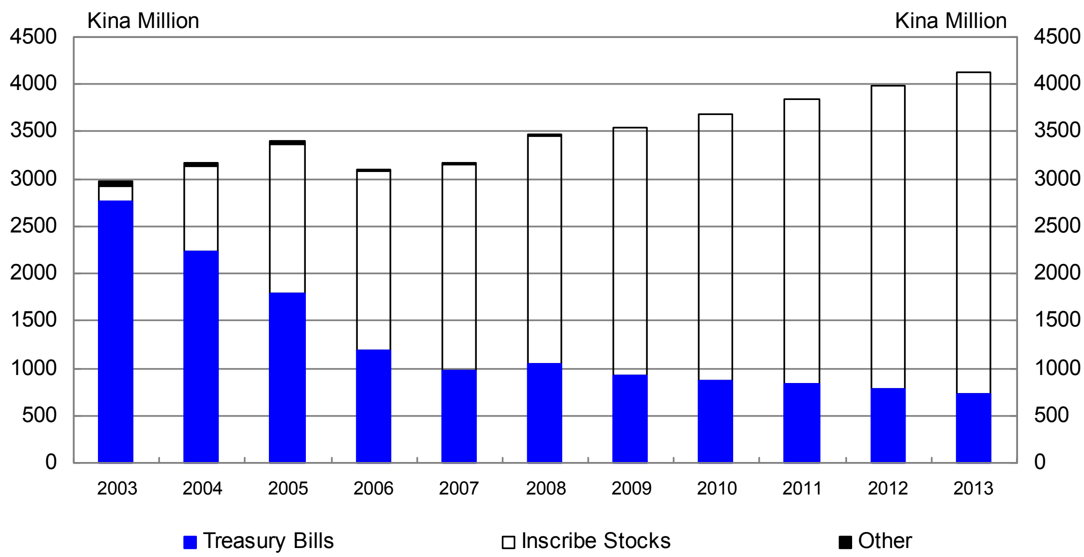
The Debt Strategy will maintain the average maturity at about 5 years for the domestic debt portfolio, and an average maturity at about 8 years for foreign-currency debt.

The Debt Strategy will aim to broaden the number and type of investors, and there will be continued efforts to improve communication with investors and to involve the Minister on presentations to current and potential investors.

The Debt Strategy will consider any recommendations from the Financial Sector Assessment regarding the capacity of the financial sector to safely invest in Government securities without crowding out the private-sector borrowers or increasing the contingent liabilities of the State.

Treasury has reviewed its targets for the use of long-term fixed-rate debt relative to short-term variable-rate debt, and plans to increase Inscribed Stocks from K2.4 billion at the end of 2008 to K3.4 billion in 2013, while increasing the maximum maturity of Inscribed Stocks from the current maximum of 17 years to 20 years, and limiting the amount of Inscribed Stocks maturing in any one year to K500 million.

Figure 29: Composition of Domestic Debt 2003 – 2013 (Kina Millions)



Source: Department of Treasury

10.3.5 Operational Risk

Operational risk is defined by the Bank of International Settlements as risk of losses resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk.

The operational risks facing Treasury include the difficulty in developing and retaining skilled staff, the lack of a business continuity plan, and a heavy dependence on the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS).

Treasury mitigates these operational risks through a capacity development plan, and by working in partnership with the Commonwealth Secretariat and other CSDRMS users to continue to improve the effectiveness of CSDRMS and to provide CSDRMS training. Treasury must formulate and regularly test a business continuity plan.

10.4 DEVELOPING GOVERNMENT INSCRIBED STOCKS, BILL AND LOAN MARKETS

There was little progress in developing the domestic market in 2008. In part, this was due to staff turnover. To counter this lack of specialised staff, Treasury has established a Domestic Debt Market Project in partnership with the domestic financial institutions. Two of the staff are from private-sector financial institutions, and half of the steering committee will be senior executives or chief executive officers of local financial institutions.

The Project will make the three most important, feasible improvements identified by stakeholders in 2007: (i) improving coordination between State entities responsible for financial obligations; (ii) providing investors with data that meet the IMF's debt data dissemination standards, and (iii) removing barriers and improving communication so as to broaden the investor base.

10.5 LONGER-TERM IMPROVEMENTS

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. Treasury will consider the recommendations of the IMF's Financial Sector Assessment, and the Debt Management Review by the World Bank or independent consultant. Treasury will survey all stakeholders 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 2010. Longer-term strategies could include:

- Developing a whole-of-government risk management framework based on asset-liability management principles
- Development of stochastic risk measures and limits
- Development of liquid primary and secondary markets in Kina-denominated Inscribed Stocks, Bills and Loans

These longer-term initiatives are not currently feasible given the limited resources and competing priorities of the Government and stakeholders. These improvements are complex and will take many years to implement as they will involve investors and financial institutions, as well as the judiciary, the legal and accounting profession, regulators, utility providers, industry organisations and other public sector entities responsible for managing financial asset, liabilities and exposures.

APPENDIX 1: REVENUE TABLES

Table 1.1: Summary of Infrastructure Tax Credit Scheme (Kina millions)

	Actual 2005	Actual 2006	Actual 2007	Est. 2008	Proj 2009
Total Mining & Petroleum Taxes Paid	1076.8	1946.5	2333.9	2392.2	626.5
Mining & Petroleum Taxes Paid by Companies involved in ITC	1076.8	1946.5	2333.9	2392.2	626.5
Total ITC Claimed & Allowed[1]	20.3	23.3	20.6	35.0	40.0
Expenditure Incurred on Approved ITC Projects[2]	84.9	63.4	62.1	85.9	70.0
Tax Credit Claimed as Percentage of Taxes Paid by Companies Subject to ITC	1.9	1.2	0.9	1.5	6.4
Excess Credits Carried Forward (from prior years)[3]	na	na	na	na	na

Notes:
1. Actual deductions for tax credits to Mining and Petroleum companies involving in the scheme. These numbers are derived from the Treasury Management System (TMS) thus represents actual impact on the government's cash flow in each fiscal year.
2. Actual expenditures incurred by the companies participating in the tax credit scheme. Some portion of the credits will be carried forward for deductions against income in the next year.
3. The level of excess credits carried forward will fully be determined next year once this scheme is being reviwed.

Source: Department of Treasury, National Planning and Monitoring and Internal Revenue Commission

Table 1.2: Incentives Under the Income Tax Act Resulting in Permanent Loss of Revenue (Kina)

Section	Description	2004 Number	Amount	2005 Number	Amount	2006 Number	Amount	2007 Number	Amount	Grand Total Amount
25	Institutions and Hospitals	3	224,514	4	348,014	2	148,414			720,942
25A	Charitable Institutions	7	10,773,469	6	8,164,869	2	3,901,519			22,839,857
27	Non-Profit Bodies	8	896,004	1	23,911	3	896,816	2	3,101,292	1,816,731
35(1)	Exempt interest	14	830,886	17	1,403,878	7	502,516	2	27,534	2,737,280
35A	Fishing Operations	1	609,560							609,560
45B	Export Sales Exemptions	3	792,122	4	14,896,443	5	18,912,204			34,600,769
45I	Rural Development	4	11,556,444	4	3,592,213	4	2,144,577			17,293,234
45N	Bougainville Incentive	1	128,263							128,263
46AA	Rabaul Incentive	1	121,517							121,517
69A	Gifts to Sporting Bodies	7	79,695	1	158,397	2	3,700			241,792
69C	Gifts to Law, Order and Justice			1	261					261
69E	Gifts to Charities	5	123,531	4	9,646	1	450			133,627
69I	Gifts to National Day Celebrations					1	10,000			10,000
69J	Gifts to PNGSC 2000 Olympics									
70A	Deduction for Education Expenses	21	528,172	22	404,107	13	149,090			1,081,369
72A	Double Deduction - Training	21	2,075,023	32	3,775,209	20	1,790,694	1	27,896	7,640,926
72C	Double Deduction - Export Market Development	2	54,069	4	119,357	6	144,895	1	674	318,321
95	Research and Development - 150%									
97A	Primary Production Development Expenditure	1	1,854,252	2	2,848,016	1	4,149,637			8,851,905
97B	Agriculture Extension Services - 150%									
CH 119	Pioneer Industries									
		99	**30,647,521**	**102**	**35,744,321**	**67**	**32,754,512**	**6**	**3,157,396**	**99,146,354**

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)

		2003		2004		2005		2006		Grand Total
Section	Description	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Amount
68A	Solar Heating							1	5,796	5,796
										-
73(3)	Depreciation 20% loading	1	32,629	2	19,978	2	3,071,724	6	340,776	3,465,107
73(6)	Depreciation non-oil fired plant	1	37,434							37,434
73(7)	Depreciation - industrial plant	9	20,057,866	4	4,773,645	7	5,997,844	5	4,331,053	35,160,408
73(9)	Depreciation - Primary Production	4	13,831,735	2	1,192,744	3	2,128,907	1	218,446	17,371,832
		15	**33,959,664**	**8**	**5,986,367**	**12**	**11,198,475**	**13**	**4,896,071**	**56,040,577**

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	2007 Number	Amount	2008 Number	Amount	Grand Total Amount
Item 5	First Time Home	791	1,660,177	651	1,487,105	3,147,282
	Buyers Exemption					-
						-
Item 5	Charities	9	251,012	6	136,800	387,812
						-
Item 8	Wills	4	38,000	-	-	38,000
						-
Item 16	Transfers of marketable	-	-	-	-	-
	securities					-
						-
Section 6	Purchase of Property by	12	2,507,437	9	279,500	2,786,937
	State Instrumentalities					-
						-
		816	**4,456,626**	**666**	**1,903,405**	6,360,031

Note: Number means number of transactions
2007 Figures are from January to December 2007
2008 Figures are from January to September 2008
A dash means no exemptions were granted

Source: Internal Revenue Commission

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 of the Provinces (Kina Thousands)

Table 2.1: National Government Grants to Provincial and Local Level Governments (Kina Thousands)

	Personal Emoluments						Goods and Services											
	Salaries		Leave Fares															
	PS Salaries	Teachers Salaries	PS Leave Fares	Teachers Leave Fares	Village Court Allowance	**Sub Total PE**	Admin Grant	Other Services Grant	Health Function	Education Function	Transport Function	Village Court Function	Agriculture Function Grant	LLG Grants	Town & Urban Services	ABG Goods and Services	**Sub Total G&S**	**Total**
Western	9,018.2	22,153.3	222.6	855.6	161.0	**32,410.7**	141.0	141.0	875.5	892.5	1,403.4	127.6	618.1	1,966.8	0.0	0.0	**6,165.8**	**38,576.5**
Gulf	7,943.5	9,501.5	368.8	597.9	124.0	**18,535.7**	347.0	471.1	1,128.4	1,383.2	754.3	49.0	532.8	1,014.7	0.0	0.0	**5,680.4**	**24,216.1**
Central	12,313.3	26,813.2	290.3	1,800.0	274.3	**41,491.1**	404.8	1,252.3	1,561.0	2,090.9	2,095.7	153.9	257.6	1,450.3	0.0	0.0	**9,266.5**	**50,757.6**
NCD	0.0	0.0	0.0	0.0	100.0	**100.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3,109.4	0.0	**3,109.4**	**3,209.4**
Milne Bay	10,721.7	25,517.0	318.0	994.5	292.0	**37,843.2**	718.7	1,017.7	1,876.9	1,715.2	1,690.3	76.2	556.0	1,850.5	0.0	0.0	**9,501.5**	**47,344.7**
Oro	7,780.9	12,113.8	312.1	822.3	127.3	**21,156.4**	441.5	441.5	1,120.1	1,109.8	1,187.8	42.5	773.4	1,406.1	0.0	0.0	**6,522.7**	**27,679.1**
S. Highlands	16,983.4	34,547.3	416.9	760.9	514.8	**53,223.3**	855.0	916.5	2,048.2	1,839.5	1,419.4	257.3	46.7	4,461.6	0.0	0.0	**11,844.2**	**65,067.5**
Enga	14,246.3	22,912.3	234.2	912.8	526.6	**38,832.2**	485.3	1,126.6	1,829.4	929.3	2,637.2	153.3	89.2	2,175.4	0.0	0.0	**9,425.6**	**48,257.8**
W. Highlands	11,100.0	32,674.5	434.6	949.8	398.3	**45,557.2**	500.0	613.4	1,773.0	2,402.0	2,459.4	274.3	1,199.7	3,539.3	0.0	0.0	**12,761.1**	**58,318.3**
Simbu	8,880.3	27,134.9	217.1	478.4	350.4	**37,061.1**	712.3	1,199.2	1,370.0	2,065.7	1,884.3	150.2	144.6	1,972.3	0.0	0.0	**9,498.7**	**46,559.7**
E. Highlands	11,978.8	31,100.0	654.4	988.4	402.9	**45,124.5**	900.0	1,328.1	2,280.9	2,956.7	2,556.5	153.0	1,025.5	3,459.8	0.0	0.0	**14,660.5**	**59,785.0**
Morobe	13,252.7	49,427.9	707.7	1,000.0	329.9	**64,718.2**	910.3	910.3	722.3	1,644.0	3,043.3	113.7	373.4	5,632.9	0.0	0.0	**13,350.1**	**78,068.3**
Madang	10,640.2	26,118.3	103.8	796.1	282.2	**37,940.6**	704.8	1,440.3	2,056.0	1,967.8	2,459.4	78.3	760.2	3,237.0	0.0	0.0	**12,703.6**	**50,644.2**
East Sepik	11,831.1	25,093.0	400.0	994.5	443.6	**38,762.2**	973.2	1,301.4	2,977.5	2,898.9	3,405.7	167.3	850.6	3,064.9	0.0	0.0	**15,639.6**	**54,401.7**
Sandaun	8,734.0	19,602.3	456.1	978.3	157.7	**29,928.4**	777.7	1,091.0	1,882.6	1,809.9	1,812.8	67.1	382.1	1,926.4	0.0	0.0	**9,749.6**	**39,678.1**
Manus	4,803.4	9,077.0	178.8	525.0	159.1	**14,743.3**	252.8	707.4	911.4	876.7	1,207.7	73.3	101.5	471.3	0.0	0.0	**4,602.1**	**19,345.4**
New Ireland	8,250.3	16,618.9	276.4	761.3	174.0	**26,080.9**	184.7	184.7	863.6	845.0	1,020.8	51.7	547.3	1,086.5	0.0	0.0	**4,784.3**	**30,865.2**
E. New Britain	11,293.9	31,860.6	243.8	987.5	184.6	**44,570.4**	81.1	516.6	1,930.7	2,663.0	2,232.5	70.6	1,527.3	2,186.1	0.0	0.0	**11,207.8**	**55,778.2**
W. New Britain	7,761.5	22,633.6	167.4	994.5	171.9	**31,728.9**	128.2	155.1	1,238.2	1,544.2	771.7	165.3	4,330.6	1,629.3	0.0	0.0	**9,962.5**	**41,691.4**
Bougainville	10,375.6	26,153.9	245.2	882.5	0.0	**37,657.2**	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	19,384.0	**19,384.0**	**57,041.2**
Total	**197,909.1**	**471,053.3**	**6,248.2**	**17,080.4**	**5,174.6**	**697,465.6**	**9,518.1**	**14,814.1**	**28,445.9**	**31,634.3**	**34,042.0**	**2,224.6**	**14,116.6**	**42,531.0**	**3,109.4**	**19,384.0**	**199,820.0**	**897,285.6**

Table 2.2: Grants, transfers and other resources to Provincial Governments (Kina Thousands)

	Total Grants and Transfers from the			Non-Grant Tax Transfers					
	Recurrent Budget	Development Budget	**Sub Total National Government**	GST (1)	Bookmakers Tax (2)	Mining & Petroleum Dividends & Royalties (3)	Own Source Revenues (4)	**Sub Total Non-Grant**	**Total**
Western	38,576.5	25,000.0	**63,576.5**	2,908.3	0.0	41,352.6	85.8	**44,346.6**	**107,923.2**
Gulf	24,216.1	12,750.0	**36,966.1**	542.5	0.0	2,743.9	1,697.6	**4,983.9**	**41,950.0**
Central	50,757.6	20,850.0	**71,607.6**	1,047.3	0.0	394.5	3,268.4	**4,710.2**	**76,317.8**
NCD	3,209.4	14,000.0	**17,209.4**	122,632.3	3,434.1	0.0	10,187.3	**136,253.7**	**153,463.0**
Milne Bay	47,344.7	26,250.0	**73,594.7**	2,498.5	0.0	0.0	926.6	**3,425.0**	**77,019.7**
Oro	27,679.1	9,750.0	**37,429.1**	1,099.9	0.0	0.0	270.9	**1,370.8**	**38,800.0**
S. Highlands	65,067.5	43,750.0	**108,817.5**	1,232.9	0.0	23,345.2	1,080.1	**25,658.1**	**134,475.7**
Enga	48,257.8	33,000.0	**81,257.8**	755.6	0.0	11,642.2	5,686.6	**18,084.5**	**99,342.3**
W. Highlands	58,318.3	35,000.0	**93,318.3**	11,454.9	401.1	0.0	2,083.0	**13,939.0**	**107,257.3**
Simbu	46,559.7	29,250.0	**75,809.7**	1,123.0	0.0	0.0	329.9	**1,453.0**	**77,262.7**
E. Highlands	59,785.0	47,550.0	**107,335.0**	8,319.8	237.5	513.9	1,577.0	**10,648.2**	**117,983.2**
Morobe	78,068.3	42,551.4	**120,619.7**	33,019.5	810.1	3,139.4	5,793.2	**42,762.2**	**163,382.0**
Madang	50,644.2	26,750.0	**77,394.2**	8,444.7	625.5	0.0	1,178.2	**10,248.4**	**87,642.6**
East Sepik	54,401.7	38,450.0	**92,851.7**	2,441.4	42.7	0.0	2,081.8	**4,565.8**	**97,417.6**
Sandaun	39,678.1	18,750.0	**58,428.1**	585.6	0.0	0.0	1,881.9	**2,467.5**	**60,895.5**
Manus	19,345.4	14,000.0	**33,345.4**	343.9	0.0	0.0	381.6	**725.5**	**34,070.9**
New Ireland	30,865.2	21,630.0	**52,495.2**	2,452.8	83.7	14,108.5	750.6	**17,395.5**	**69,890.7**
E. New Britain	55,778.2	36,250.0	**92,028.2**	6,547.8	329.6	0.0	2,852.7	**9,730.1**	**101,758.3**
W. New Britain	41,691.4	11,250.0	**52,941.4**	3,732.5	0.0	0.0	4,899.0	**8,631.5**	**61,572.9**
Bougainville	57,041.2	42,985.0	**100,026.2**	908.3	0.0	0.0	3,298.2	**4,206.6**	**104,232.8**
Total	**897,285.6**	**549,766.4**	**1,447,052.0**	**212,091.4**	**5,964.3**	**97,240.1**	**50,310.4**	**365,606.2**	**1,812,658.2**

(1) 60% of net inland GST collections, distributed to each province
Special distribution arrangements apply for Bougainville (Autonomy Arrangements), whereby it receives 30% of net inland GST

(2) 100% of 2007 net collections.

(3) NEFC estimate, which includes royalties and dividends from equity shares of mining and petroleum resource projects paid to Provincial Governments.
Based on Treasury estimates of projected resource project revenues.

(4) NEFC estimate (2007 actuals, except for Bougainville which is 2006)

APPENDIX 3: ECONOMIC AND FISCAL DATA TABLES

TABLE 1: GROSS DOMESTIC PRODUCT BY ECONOMIC ACTIVITY AT CURRENT AND CONSTANT PRICES (Kina Million)

	2004 Prelim.	2005 Est.	2006 Est.	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
Agriculture, Forestry and Fishing										
nominal	4550.8	5615.7	5905.3	6485.2	7500.2	8066.6	8807.6	9567.0	10192.4	10902.6
deflator	148.6	179.1	186.9	197.7	217.8	225.2	236.4	247.7	254.6	262.9
real	3062.1	3136.4	3160.5	3279.8	3444.2	3582.5	3725.1	3862.1	4003.4	4146.3
rate of real growth	4.6	2.4	0.8	3.8	5.0	4.0	4.0	3.7	3.7	3.6
Oil and Gas Extraction										
nominal	738.4	1651.3	1977.3	2044.9	2404.6	1159.2	904.2	748.3	591.8	469.6
deflator	300.5	591.8	710.2	774.0	991.4	515.6	431.2	431.2	431.2	431.2
real	245.7	279.0	278.4	264.2	242.6	224.8	209.7	173.5	137.2	108.9
rate of real growth	-8.5	13.6	-0.2	-5.1	-8.2	-7.3	-6.7	-17.2	-20.9	-20.6
Mining and Quarrying										
nominal	1652.7	1903.7	2707.2	2851.7	3009.5	2096.2	2093.6	2193.4	2211.7	2114.1
deflator	227.7	257.0	396.6	408.3	415.0	245.9	202.9	199.9	198.5	197.9
real	725.9	740.7	682.5	698.4	725.1	852.3	1031.8	1097.3	1114.1	1068.2
rate of real growth	3.6	2.0	-7.8	2.3	3.8	17.5	21.1	6.3	1.5	-4.1
Manufacturing										
nominal	848.3	942.5	999.5	1091.2	1278.2	1422.6	1523.9	1632.4	1748.6	1873.1
deflator	141.3	142.7	144.1	148.5	164.0	173.9	179.1	184.5	190.0	195.7
real	600.4	660.4	693.5	735.1	779.2	818.1	850.9	884.9	920.3	957.1
rate of real growth	2.3	10.0	5.0	6.0	6.0	5.0	4.0	4.0	4.0	4.0
Electricity, gas and water										
nominal	263.7	284.4	301.7	323.2	360.9	397.9	430.4	465.4	503.4	544.4
deflator	209.0	219.4	226.0	232.8	243.4	255.6	263.3	271.2	279.3	287.7
real	126.2	129.6	133.5	138.8	148.3	155.7	163.5	171.6	180.2	189.2
rate of real growth	4.3	2.7	3.0	4.0	6.8	5.0	5.0	5.0	5.0	5.0
Construction										
nominal	1177.0	1245.8	1437.2	1750.5	2240.6	2686.4	2927.5	3190.2	3417.4	3660.7
deflator	134.4	135.7	139.8	146.8	163.4	179.7	185.1	190.7	196.4	202.3
real	875.7	917.8	1027.9	1192.4	1371.2	1494.6	1581.3	1673.1	1740.0	1809.6
rate of real growth	3.2	4.8	12.0	16.0	15.0	9.0	5.8	5.8	4.0	4.0
Wholesale and retail trade										
nominal	890.5	944.6	1021.3	1157.2	1368.2	1537.3	1646.8	1764.0	1889.6	2024.2
deflator	160.0	163.2	166.5	171.5	189.5	200.9	206.9	213.1	219.5	226.1
real	556.4	578.7	613.4	674.7	721.9	765.3	795.9	827.7	860.8	895.2
rate of real growth	3.2	4.0	6.0	10.0	7.0	6.0	4.0	4.0	4.0	4.0
Transport, storage and communication										
nominal	304.7	317.0	326.2	364.2	440.2	536.6	574.8	615.7	659.5	706.5
deflator	141.5	142.9	140.1	110.7	95.7	101.4	104.5	107.6	110.8	114.2
real	215.3	221.8	232.8	329.0	460.0	529.0	550.1	572.1	595.0	618.8
rate of real growth	2.6	3.0	5.0	41.3	39.8	15.0	4.0	4.0	4.0	4.0
Finance, real estate and business services										
nominal	415.2	449.0	501.8	553.3	648.0	714.4	765.3	819.7	878.1	940.6
deflator	137.3	141.4	145.6	152.9	168.9	179.1	184.5	190.0	195.7	201.6
real	302.5	317.6	344.6	361.9	383.6	398.9	414.9	431.5	448.7	466.7
rate of real growth	-3.4	5.0	8.5	5.0	6.0	4.0	4.0	4.0	4.0	4.0
Community, social and personal services										
nominal	1395.0	1427.2	1521.4	1629.7	1804.5	2007.4	2108.9	2215.7	2327.8	2445.6
deflator	126.2	126.9	132.0	136.0	146.2	157.9	162.6	167.5	172.5	177.7
real	1105.5	1124.3	1152.4	1198.5	1234.5	1271.5	1296.9	1322.9	1349.3	1376.3
rate of real growth	-2.4	1.7	2.5	4.0	3.0	3.0	2.0	2.0	2.0	2.0
TOTAL GDP*										
nominal	12652.1	15194.8	17132.2	18715.6	21554.4	21161.2	22358.5	23809.6	25060.1	26321.1
rate of nominal growth	0.7	20.1	12.8	9.2	15.2	-1.8	5.7	6.5	5.3	5.0
deflator	156.0	180.8	198.7	203.8	219.0	202.6	203.4	208.8	213.2	218.6
real	8110.5	8402.2	8621.2	9182.3	9840.2	10446.3	10990.7	11402.1	11752.5	12039.8
rate of real growth	**2.7**	**3.6**	**2.6**	**6.5**	**7.2**	**6.2**	**5.2**	**3.7**	**3.1**	**2.4**
Total non-mining GDP										
nominal	10261.0	11639.8	12447.6	13818.9	16140.3	17905.8	19360.7	20867.9	22256.6	23737.3
rate of nominal growth	**-0.5**	**13.4**	**6.9**	**11.0**	**16.8**	**10.9**	**8.1**	**7.8**	**6.7**	**6.7**
deflator	143.7	157.7	162.5	168.1	181.9	191.1	198.6	206.0	211.9	218.5
real	7138.9	7382.5	7660.2	8219.7	8872.6	9369.2	9749.1	10131.3	10501.1	10862.7
rate of real growth	**3.1**	**3.4**	**3.8**	**7.3**	**7.9**	**5.6**	**4.1**	**3.9**	**3.7**	**3.4**

*Sum of industries less imputed bank service charge, plus import duties, less subsidies.

Source: Preliminary data for 2004: National Statistical Office. Estimates and projections: Dept. of Treasury

TABLE 2: CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT
(Percentage points)

	2004 Prelim.	2005 Est	2006 Est	2007 Est	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
Agriculture, Forestry and Fishing	1.7	0.9	0.3	1.4	1.8	1.4	1.4	1.2	1.2	1.22
Oil and Gas Extraction	-0.3	0.4	0.0	-0.2	-0.2	-0.2	-0.1	-0.3	-0.3	-0.24
Mining and Quarrying	0.3	0.2	-0.7	0.2	0.3	1.3	1.7	0.6	0.1	-0.39
Manufacturing	0.2	0.7	0.4	0.5	0.5	0.4	0.3	0.3	0.3	0.31
Electricity, gas and water	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.08
Construction	0.3	0.5	1.3	1.9	1.9	1.3	0.8	0.8	0.6	0.59
Wholesale and retail trade	0.2	0.3	0.4	0.7	0.5	0.4	0.3	0.3	0.3	0.29
Transport, storage and communication	0.1	0.1	0.1	1.1	1.4	0.7	0.2	0.2	0.2	0.20
Finance, real estate and business services	-0.1	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.15
Community, social and personal services	-0.3	0.2	0.3	0.5	0.4	0.4	0.2	0.2	0.2	0.23
TOTAL GDP	**2.7**	**3.6**	**2.6**	**6.5**	**7.2**	**6.2**	**5.2**	**3.7**	**3.1**	**2.44**
Total Non-mining GDP	**3.1**	**3.4**	**3.8**	**7.3**	**7.9**	**5.6**	**4.1**	**3.9**	**3.7**	**3.44**

*Sum of industries less imputed bank service charge, plus import duties, less subsidies.
Source: Preliminary data for 2004: National Statistical Office. Estimates and projections: Dept. of Treasury

TABLE 3: PRICES OF MAIN EXPORT COMMODITIES
(Kina per tonne fob, unless otherwise specified)

	2004 Actual	2005 Actual	2006 Actual	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
AGRICULTURE										
Copra	896	776	875	1051	929	871	847	822	798	799
Cocoa	5253	4495	5553	6630	8299	7412	7116	6819	6226	5930
Coffee	4505	6533	6444	7493	7893	7240	7240	7027	6761	6495
Palm Oil	1294	1132	1181	1826	2075	1879	1823	2168	2070	1979
Rubber	3632	3750	5409	5552	6380	6154	5943	5709	5522	5288
Tea	2827	2928	3212	3134	3491	2784	2590	2525	2486	2460
Copra Oil	1796	1722	1455	2368	2092	1963	1908	1852	1797	1800
Logs (K/m^3)	177	177	186	201	194	191	194	197	200	203
MINERALS										
Gold (US$/oz)	409	445	604	697	863	600	445	445	445	445
Copper (US$/lb)	1.30	1.67	3.05	3.23	3.21	1.47	1.60	1.60	1.60	1.60
Oil (Kutubu Crude: US$/barrel)	42.1	53.4	64.3	72.3	102.0	55.0	46.0	46.0	46.0	46.0

Source: Actuals from BPNG. Projections from IMF and Dept. of Treasury.

TABLE 4: VOLUME OF MAIN EXPORT COMMODITIES
('000 tonnes, unless otherwise specified)

	2004 Actual	2005 Actual	2006 Actual	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
AGRICULTURE										
Copra	19.2	22.3	12.7	11.8	20.3	11.5	11.0	10.0	10.0	10.0
Cocoa	42	44	44	47	49	51	54	55	57	59
Coffee	63	72	52	62	77	79	75	80	85	87
Palm Oil	339	346	362	368	386	420	443	465	488	512
Rubber	3.8	4.8	4.4	4.1	4.2	4.3	4.5	4.7	4.8	5.0
Tea	8.1	6.9	6.6	6.4	6.3	7.1	7.0	6.7	6.5	6.2
Copra Oil	45.1	54.4	41.5	49.9	62.2	58.6	59.5	67.2	71.4	75.6
Logs	2012	2282	2638	2835	2876	2851	2845	2655	2547	2487
MINERAL										
Gold (tonnes)	67.3	70.5	55.8	63.7	66.2	82.6	84.1	85.0	87.1	84.1
Copper	173.9	226.1	216.7	227.7	215.8	214.6	214.7	214.7	214.7	214.7
Oil (million barrels)	12.6	13.3	14.4	13.8	12.5	11.4	10.5	8.3	6.1	4.4

Source: Actuals from BPNG. Projections from Dept. of Treasury.

TABLE 5: VALUE OF MAIN EXPORT COMMODITIES
(Kina Million)

	2004 Actual	2005 Actual	2006 Actual	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
AGRICULTURE, FORESTRY, FISHERIES										
Copra	17.2	17.3	8.3	14.3	18.8	10.0	9.3	8.2	8.0	8.0
Copra Oil	81.0	93.7	60.4	117.8	130.2	115.0	113.4	124.5	128.2	136.1
Cocoa	218.0	198.7	204.4	260.8	408.2	381.4	383.0	378.0	355.5	348.7
Coffee	283.8	471.0	337.0	408.4	604.0	574.8	542.9	564.8	573.3	567.3
Palm Oil	438.7	391.4	427.9	672.2	800.8	788.6	806.8	1007.3	1010.0	1013.8
Rubber	13.8	18.0	23.8	22.9	26.9	26.8	26.6	26.6	26.8	26.6
Tea	22.9	20.2	21.2	20.0	22.2	19.7	18.0	17.0	16.1	15.4
Other Agriculture (a)	80.0	-1.8	30.6	31.9	33.1	34.5	35.9	37.3	38.8	40.8
Forest Products	459.5	476.3	520.3	671.2	665.6	647.8	657.5	621.8	606.5	597.3
Marine Products	58.2	69.4	89.1	94.4	109.6	122.1	136.4	149.4	163.2	180.0
Total Agricultural, Forestry, Fishing Expo	**1673.1**	**1754.2**	**1723.0**	**2313.9**	**2819.5**	**2720.5**	**2729.9**	**2935.0**	**2926.4**	**2934.0**
MINERAL										
Gold	2779.5	2834.1	3069.4	4048.3	4733.1	3957.8	2990.5	3023.7	3097.3	2991.1
Copper	1544.2	2497.7	4329.5	4670.3	3990.0	1757.9	1912.4	1912.4	1912.4	1912.4
Oil	1652.2	2283.1	2967.3	3099.4	3592.5	1708.0	1314.2	1038.4	761.2	545.1
Refined Petroleum Products	202.8	496.8	263.9	503.5	375.7	199.3	170.1	173.5	176.9	180.5
Other	31.6	37.0	39.3	55.2	44.9	34.4	704.0	885.8	860.3	830.6
Total Mineral Exports	**6210.3**	**8148.7**	**10669.4**	**12376.7**	**12736.3**	**7657.5**	**7091.1**	**7033.8**	**6808.1**	**6459.7**
TOTAL EXPORT VALUE	**7883.4**	**9902.9**	**12392.5**	**14690.6**	**15555.8**	**10378.0**	**9821.0**	**9968.8**	**9734.5**	**9393.7**

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)

	2004 Actual	2005 Actual	2006 Actual	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
CURRENT ACCOUNT BALANCE	**393**	**1887**	**1255**	**366**	**1880**	**-1579**	**-2133**	**-920**	**-916**	**-1054**
Balance of Trade in Goods and Services	**969**	**2754**	**3113**	**1758**	**3099**	**-1550**	**-2092**	**-869**	**-870**	**-1026**
Goods Balance	*3530*	*5437*	*6668*	*6098*	*7482*	*2285*	*1783*	*3039*	*3068*	*2951*
Credit (Exports)	8233	10168	12752	13895	15556	10378	9821	9969	9734	9394
Debit (Imports)	-4703	-4731	-6084	-7797	-8074	-8093	-8038	-6930	-6666	-6443
Services Balance	*-2561*	*-2683*	*-3554*	*-4340*	*-4383*	*-3835*	*-3876*	*-3907*	*-3938*	*-3976*
Services Credit	656	938	965	1069	834	842	899	965	1020	1072
Services Debit	-3217	-3621	-4519	-5409	-5217	-4677	-4775	-4872	-4959	-5048
Income Balance	**-1406**	**-1670**	**-2462**	**-2134**	**-2374**	**-1043**	**-1022**	**-1035**	**-1031**	**-1015**
Income Credit	64	81	215	309	133	138	141	145	148	151
Income Debit	-1470	-1751	-2677	-2443	-2507	-1181	-1164	-1180	-1180	-1167
Transfers Balance	**830**	**803**	**604**	**742**	**1155**	**1014**	**981**	**984**	**985**	**987**
Transfers Credit	1080	1093	1000	1219	1645	1486	1478	1511	1539	1567
Transfers Debit	-250	-290	-396	-477	-490	-472	-496	-527	-554	-580
CAPITAL AND FINANCIAL ACCOUNT[(a)]	**-410**	**-1886**	**-1239**	**-411**	**-1880**	**1579**	**2133**	**920**	**916**	**1054**
NET ERRORS AND OMISSIONS	17	-1	-16	45	0	0	0	0	0	0
Current account balance as percentage of Gross Domestic Product (GDP)	3.1	12.4	7.3	2.0	8.7	-7.5	-9.5	-3.9	-3.7	-4.0

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)

	2002 Annual	2003 Annual	2004 Annual	2005 Annual	2006 Annual	2007 Annual	2008 June Qtr
Retail	97.9	96.9	93.1	93.7	97.7	115.1	124
Wholesale	103.3	113.3	123.8	130.7	145.6	158.0	161.6
Manufacturing	104.1	110.9	117.7	127.5	132.6	142.4	154.1
Building and Construction	99.0	124.1	107.9	98.4	118.9	135.4	148.5
Transportation	106.3	106.1	106.8	106.1	108.2	115.2	122
Agriculture, Forestry, Fisheries	103.9	114.1	112.9	112.9	123.3	139.1	152.7
Financial and Business	99.1	100.8	104.7	105.7	112.4	114.4	124.9
TOTAL NON-MINERAL	**102.2**	**108.5**	**109.2**	**111.0**	**119.1**	**131.1**	**142.8**
MINERAL	98.8	97.6	95.6	101.5	111.1	128.5	134.8

Source: BPNG.

TABLE 8: CENTRAL GOVERNMENT REVENUE AND GRANTS
(Kina Million)

	2004 Actual	2005 Actual	2006 Actual	2007 Actual	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
TAX REVENUE	**3220.1**	**3744.0**	**4944.8**	**5854.0**	**6116.2**	**4614.3**	**4705.7**	**4936.6**	**5173.8**	**5415.5**
TAX ON INCOME AND PROFITS	2223.4	2770.8	3823.5	4491.3	4659.1	3043.9	3016.9	3130.1	3258.5	3384.3
Personal Income Tax	826.5	841.0	907.0	1006.9	1086.2	1195.1	1278.8	1383.3	1495.1	1614.8
Company tax	436.7	516.5	550.6	723.7	778.2	877.3	933.5	1006.2	1073.1	1144.5
DWT	123.2	154.7	200.9	199.3	196.8	144.2	155.7	153.8	149.6	139.0
Mining and Petroleum Taxes	634.3	1076.8	1946.5	2333.9	2392.2	626.5	434.4	357.9	297.4	227.4
Interest withholding tax	33.3	17.9	22.1	19.3	21.1	19.1	19.1	19.1	19.1	19.1
Other Direct	78.6	72.1	92.4	111.2	93.1	85.8	92.8	100.0	106.7	113.8
Gaming Tax	90.7	91.9	104.0	97.0	91.6	95.9	102.7	109.8	117.5	125.8
DOM. TAXES ON GOODS AND SERVICES	620.8	657.3	784.3	958.5	1031.7	1114.2	1200.6	1296.6	1380.6	1467.6
Excise	203.1	255.9	324.1	342.00	370.2	407.5	426.1	459.3	489.8	522.4
GST	315.7	326.2	401.1	557.5	646.1	703.0	770.6	833.0	886.2	940.3
Mining Levy	101.3	73.1	56.1	56.6	12.0	0.0	0.0	0.0	0.0	0.0
Other Indirect	0.7	2.1	3.0	2.4	3.3	3.7	4.0	4.3	4.6	4.9
TAXES ON INTERNATIONAL TRADE	375.9	315.9	337.0	404.2	425.4	456.2	488.1	510.0	534.6	563.5
Import Duty	151.1	101.1	90.4	135.9	149.9	166.3	179.8	193.8	206.7	220.4
Export Duty	101.5	136.3	162.6	155.2	152.0	152.9	160.2	156.5	157.6	161.5
Excise Duty on Imports	123.3	78.5	84.0	113.1	123.5	137.0	148.1	159.7	170.3	181.6
NON TAX REVENUE	**245.1**	**279.3**	**428.8**	**433.0**	**479.3**	**1037.8**	**268.8**	**261.6**	**270.2**	**279.4**
PROPERTY INCOME	164.7	188.2	339.3	312.7	376.5	322.9	166.6	151.6	151.6	151.6
Dividends	105.0	50.0	68.1	87	140	195	75	60	60	60
Mining and Petroleum Dividends	59.7	138.2	271.2	225.7	236.5	127.9	91.6	91.6	91.6	91.6
Other*										
INTEREST AND FEES FROM LENDING	2.8	0.5	0.6	0.5	9.0	24.0	9.0	9.0	9.0	9.0
OTHER NON TAX REVENUE	77.6	90.7	88.9	119.8	93.7	90.9	93.2	101.0	109.5	118.8
INJECTIONS FROM TRUST ACCOUNTS						600.0				
ASSET SALES	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL REVENUE	**3465.2**	**4023.4**	**5373.6**	**6287.0**	**6595.5**	**5652.1**	**4974.5**	**5198.3**	**5444.0**	**5694.9**
% of GDP	27.4%	26.5%	31.4%	33.6%	30.6%	26.7%	22.2%	21.8%	21.7%	21.6%
INFRASTRUCTURE TAX CREDITS	**34.7**	**20.3**	**23.3**	**20.6**	**73.7**	**40.0**	**40.0**	**40.0**	**40.0**	**40.0**
GRANTS	**849.7**	**1283.1**	**914.6**	**721.0**	**1111.2**	**974.3**	**940.0**	**940.0**	**940.0**	**940.0**
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	849.7	1283.1	914.6	721.0	1111.2	974.3	940.0	940.0	940.0	940.0
TOTAL REVENUE AND GRANTS	**4349.6**	**5326.8**	**6311.6**	**7028.6**	**7780.4**	**6666.4**	**5954.5**	**6178.3**	**6424.0**	**6674.9**
% of GDP	34.4%	35.1%	36.8%	37.6%	36.1%	31.5%	26.6%	25.9%	25.6%	25.4%
PRINCIPAL RECEIPTS FROM LENDING	**10.4**	**2.7**	**4.2**	**4.1**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**
GROSS BORROWING	**1433.7**	**1665.8**	**1268.2**	**4797.4**	**2299.7**	**1691.8**	**1405.4**	**1691.6**	**1473.3**	**1269.2**
ASSET SALES	**25.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
TOTAL RECEIPTS	**5818.7**	**6995.3**	**7584.0**	**11830.1**	**10084.1**	**8362.2**	**7363.9**	**7873.9**	**7901.3**	**7948.0**
% of GDP	46.0%	46.0%	44.3%	63.2%	46.8%	39.5%	32.9%	33.1%	31.5%	30.2%

Source: Department of Treasury.

TABLE 9: CENTRAL GOVERNMENT EXPENDITURE
(Kina Million)

	2004 Actual	2005 Actual	2006 Actual	2007 Est	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
RECURRENT BUDGET										
NATIONAL DEPARTMENTS	1555.1	1833.1	1665.9	2098.4	2275.7	2364.5	2376.3	2465.8	2603.1	2608.9
Personal Emoluments (a)	682.2	690.5	698.0	834.7	945.4	943.7	1054.8	1087.0	1119.5	1152.2
Goods and Services	872.9	1142.6	967.9	1263.7	1330.4	1420.8	1321.5	1378.8	1483.6	1456.6
General Goods and Services	534.9	904.0	786.6	1050.8	1084.1	1207.4	1110.7	1167.4	1271.6	1243.1
Education Subsidies	39.5	40.9	42.4	148.9	143.0	143.0	144.5	146.0	147.6	149.2
Pre-March 2003 Arrears Payments	141.8	36.2	33.9	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Structural Adjustment Payments	66.7	104.5	30.3	6.8	51.3	18.4	14.4	13.4	12.4	12.4
Court Orders	90.0	57.0	74.7	56.0	52.0	52.0	52.0	52.0	52.0	52.0
PROVINCIAL DEPARTMENTS	656.0	632.5	765.1	745.0	728.4	840.2	887.8	951.9	1018.6	1091.5
Personal Emoluments	580.2	543.4	662.5	621.6	601.5	659.8	692.3	726.5	762.4	800.3
Staffing Grants	183.0	162.5	191.3	183.6	171.0	198.7	204.8	211.2	217.7	224.4
Teachers' Salaries	397.2	380.9	471.2	438.0	430.5	461.1	487.5	515.3	544.8	575.9
Goods and Other Services	54.0	54.6	65.1	65.4	65.9	98.5	103.6	108.8	114.4	120.2
Administration / Block Grants	17.5	11.8	21.3	16.1	15.5	24.3	25.2	26.0	26.9	27.8
Health Function Grant	9.1	11.8	11.5	13.4	14.5	28.4	30.2	32.1	34.0	36.1
Education Subsidies / Function Grant	16.9	19.8	20.6	21.6	21.7	31.6	33.6	35.6	37.8	40.1
Derivation/Agriculture Function Grant	10.5	11.2	11.7	14.3	14.1	14.1	14.6	15.1	15.6	16.2
Conditional Grants	21.8	34.5	37.5	58.0	60.9	81.9	91.9	116.6	141.7	171.0
Provincial Infr / Transp Maint Grant	12.5	12.7	14.4	15.4	16.7	34.0	36.2	38.4	40.7	43.2
Local & Village Services / Rural LLG	3.8	15.4	16.5	37.4	30.9	33.7	35.8	38.0	40.3	42.8
Town and Urban Services/Urban LLG Grant	5.6	6.4	6.6	3.0	11.1	11.9	12.6	13.4	14.2	15.1
Village Court Function Grant				2.2	2.2	2.2	2.4	2.5	2.7	2.8
Equalisation Grant				0.0	0.0	0.0	5.0	24.3	43.8	67.1
AUTONOMOUS BOUGAINVILLE GOVERNMENT	35.0	45.3	46.5	50.0	54.2	57.0	60.1	63.4	66.8	70.5
Police Grant			2.0	2.1	2.2	2.3	2.5	2.6	2.8	3.0
Recurrent Grant	30.0	40.3	44.5	47.9	51.8	54.4	57.7	60.8	64.0	67.5
Conditional Grant				0.0	0.3	0.3	0.0	0.0	0.0	0.0
TRANSFERS TO STAT. INS.	207.9	206.7	234.3	238.6	226.8	253.9	257.7	261.5	265.4	269.1
INTEREST PAYMENTS AND FEES	377.0	332.8	307.0	370.1	358.2	392.8	372.5	383.3	391.1	402.1
Domestic	239.0	216.1	187.1	252.2	275.3	304.0	311.0	325.4	341.8	361.4
External	138.0	116.7	119.9	117.9	82.9	88.8	61.4	57.9	49.3	40.7
NET LENDING TO CSAs	-10.4	-2.7	-4.2	-4.1	-4.0	-4.0	-4.0	-4.0	-4.0	-4.0
TOTAL RECURRENT	**2820.4**	**3047.6**	**3014.7**	**3498.0**	**3639.3**	**3904.5**	**3950.5**	**4122.0**	**4341.0**	**4438.0**
% of GDP	22.3%	20.0%	17.7%	18.7%	16.9%	18.5%	17.7%	17.3%	17.3%	16.9%
DEVELOPMENT BUDGET										
GoPNG FUNDED PROJECTS	477.6	588.1	639.5	606.6	763.4	1620.9	1039.2	1084.5	1109.0	1268.7
DOMESTIC FUNDS	331.6	431.8	471.2	483.2	526.7	1385.9	791.6	827.9	843.7	994.4
INFRASTRUCTURE TAX CREDITS	34.7	20.3	23.3	20.6	73.7	40.0	40.0	40.0	40.0	40.0
CONCESSIONAL LOANS	94.6	134.0	145.0	101.8	163.0	195.0	207.6	216.5	225.3	234.3
COMMERCIAL LOANS	16.8	2.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
DONOR FUNDED PROJECTS										
PROJECT GRANTS	849.7	1283.1	914.6	721.0	1111.2	974.3	940.0	940.0	940.0	940.0
TOTAL DEVELOPMENT (PIP)	**1327.4**	**1871.2**	**1554.1**	**1327.6**	**1874.6**	**2595.2**	**1979.2**	**2024.5**	**2049.0**	**2208.7**
% of GDP	10.5%	12.3%	9.1%	7.1%	8.7%	12.3%	8.9%	8.5%	8.2%	8.4%
REAPPROPRIATION INTO TRUST ACCOUNT						177.0				
ADDITIONAL INVESTMENT/PRIORITY EXPENDITURE		**400.0**	**1207.0**	**1726.8**	**2276.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
% of GDP		2.6%	0.1	9.2%	10.6%	0.0%	0.0%	0.0%	0.0%	0.0%
TOTAL EXPENDITURE AND NET LENDING	**4147.8**	**5319.1**	**5775.8**	**6552.4**	**7789.9**	**6676.7**	**5929.7**	**6146.5**	**6389.9**	**6646.7**
% of GDP	32.8%	34.8%	33.9%	35.0%	36.1%	31.6%	26.5%	25.8%	25.5%	25.3%
AMORTISATION	**1613.2**	**1673.4**	**1625.5**	**5123.0**	**2290.2**	**1681.5**	**1430.2**	**1723.5**	**1507.3**	**1297.3**
Domestic	1176.4	1374.0	1255.0	4622.0	1834.0	1425.9	1057.3	1316.4	1104.8	887.6
External	436.8	299.4	370.5	501.0	456.2	255.6	372.9	407.1	402.5	409.7
LOAN REPAYMENTS	**10.4**	**2.7**	**4.2**	**4.1**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**
TOTAL PAYMENTS	**5771.4**	**6995.2**	**7405.5**	**11679.5**	**10084.1**	**8362.2**	**7363.9**	**7873.9**	**7901.3**	**7948.0**
% of GDP	45.6%	45.8%	43.4%	62.4%	46.8%	39.5%	32.9%	33.1%	31.5%	30.2%

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)

	2004 Actual	2005 Actual	2006 Actual	2007 Est	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
TOTAL REVENUE AND GRANTS	4349.6	5326.8	6311.6	7028.6	7780.4	6666.4	5954.5	6178.3	6424.0	6674.9
TOTAL EXPENDITURE AND NET LENDING	4147.8	5319.1	5775.8	6552.4	7789.9	6676.7	5929.7	6146.5	6389.9	6646.7
DEFICIT (-) / SURPLUS (+)	**201.8**	**7.6**	**535.8**	**476.2**	**-9.5**	**-10.3**	**24.8**	**31.8**	**34.0**	**28.1**
% of GDP	1.6%	0.1%	3.1%	2.5%	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%
NET EXTERNAL FINANCING	**-325.4**	**-163.4**	**-219.0**	**-397.3**	**-293.2**	**-60.6**	**-165.3**	**-190.6**	**-177.2**	**-175.4**
CONCESSIONAL FINANCING	-147.2	-84.0	-145.0	-206.2	-244.5	-14.2	-114.6	-132.3	-122.2	-119.8
New Borrowing	94.6	134.0	145.0	102.7	163.0	195.0	207.6	216.5	225.3	234.3
Less Amortisation	-241.8	-218.0	-290.0	-308.9	-407.5	-209.2	-322.2	-348.8	-347.5	-354.1
COMMERCIAL FINANCING	-9.9	-18.0	-11.0	-14.7	-16.0	-15.4	-14.7	-14.7	-14.7	-14.7
New Borrowing	16.8	2.0	6.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Less Amortisation	-26.7	-20.0	-17.0	-15.6	-16.0	-15.4	-14.7	-14.7	-14.7	-14.7
EXTERNAL EXTRAORDINARY FINANCING	-168.3	-61.4	-63.0	-176.4	-32.7	-31.0	-36.0	-43.6	-40.3	-40.9
New Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less Amortisation	-168.3	-61.4	-63.0	-176.4	-32.7	-31.0	-36.0	-43.6	-40.3	-40.9
NET DOMESTIC FINANCING	**123.5**	**155.8**	**-316.8**	**-54.2**	**302.7**	**70.9**	**140.5**	**158.7**	**143.2**	**147.2**
DOMESTIC MARKET BORROWING	154.1	225.0	-304.0	72.7	302.7	70.9	140.5	158.7	143.2	147.2
New Borrowing	1377.9	1599.0	1130.0	4694.7	2136.7	1496.8	1197.8	1475.1	1248.0	1034.8
Less Amortisation	-1223.8	-1374.0	-1434.0	-4622.0	-1834.0	-1425.9	-1057.3	-1316.4	-1104.8	-887.6
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	25.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER DOMESTIC FINANCING	-55.6	-69.2	-12.8	-126.9	0.0	0.0	0.0	0.0	0.0	0.0
Change in check float	87.8	-102.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
End period stock	252.8	150.0	150.0	-300.6	300.6	300.6	300.6	300.6	300.6	300.6
less: Beginning period stock	-165.0	-252.8	-150.0	300.6	-300.6	-300.6	-300.6	-300.6	-300.6	-300.6
POSF financing (a)	-63.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BPNG financing		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing Discrepancy	-80.4	33.6	-12.8	-126.9	0.0	0.0	0.0	0.0	0.0	0.0
NET FINANCING	**-201.9**	**-7.6**	**-535.8**	**-451.5**	**9.5**	**10.3**	**-24.8**	**-31.8**	**-34.0**	**-28.1**
MEMO:										
FINANCING REQUIREMENT	123.6	155.8	-316.8	-78.9	302.7	70.9	140.5	158.7	143.2	147.2
% of GDP	1.0	1.0	-1.8%	-0.4%	1.4%	0.3%	0.6%	0.7%	0.6%	0.6%
GROSS BORROWING	1433.7	1665.8	1268.2	4797.4	2300	1692	1405	1692	1473	1269
Domestic	1322.3	1529.8	1117.2	4695	2137	1497	1198	1475	1248	1035
External	111.4	136.0	151.0	0.0	163.0	195.0	207.6	216.5	225.3	234.3
Concessional	94.6	134.0	145.0	102.7	163.0	195.0	207.6	216.5	225.3	234.3
Commercial	16.8	2.0	6.0	0.0	0.0	0	0	0	0	0
Extraordinary	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Financing gap										
GROSS AMORTIZATION	1660.6	1673.4	1804.0	5123.0	2290.2	1681.5	1430.2	1723.5	1507.3	1297.3
Domestic	1223.8	1374.0	1434.0	4622.0	1834.0	1425.9	1057.3	1316.4	1104.8	887.6
External	436.8	299.4	370.0	501.0	456.2	255.6	372.9	407.1	402.5	409.7
Concessional	241.8	218.0	290.0	308.9	407.5	209.2	322.2	348.8	347.5	354.1
Commercial	26.7	20.0	17.0	15.6	16.0	15	15	15	15	15
Extraordinary	168.3	61.4	63.0	176.4	32.7	31.0	36.0	43.6	40.3	40.9

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)

	2004 Actual	2005 Actual	2006 Actual	2007 Actual	2008 June*
Domestic Credit	1798.90	2241.10	3036.40	4049.20	5027.30
% Change	0.3	24.6	35.5	33.4	38.0
Net Credit to Central Government	1293.50	1114.10	962.40	171.20	258.40
% Change	3.2	-13.9	-13.6	-82.2	-69.4
Credit to Private Sector	1723.60	2132.80	2948.90	3961.10	4931.40
% Change	0.9	23.7	38.3	34.3	38.5
Money Supply	3914.80	5069.30	7040.20	8994.00	9953.60
% Change	14.8	29.5	38.9	27.8	27.6
Money Velocity (M3*) (average)	3.2	3.0	2.4	2.1	2.2

Source: BPNG
*through -the -year change

TABLE 12: PUBLIC DEBT
(Kina Million, unless otherwise stated)

	2004 Actual	2005 Actual	2006 Actual	2007 Est	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
Domestic	3181.2	3403.8	3101.0	3173.3	3474.0	3544.9	3685.4	3844.1	3987.3	4134.5
Treasury Bills***	2236.2	1796.5	1194.0	980.2	1052.3	927.9	873.0	836.1	779.3	726.6
Inscribed Stock	898.0	1567.9	1883.0	2174.8	2408.0	2608.0	2808.0	3008.0	3208.0	3408.0
Other Domestic debt**	47.0	39.4	24.0	18.3	13.7	9.0	4.4	0.0	0.0	0.0
Domestic debt as % GDP	25.1%	22.4%	18.1%	17.0%	16.1%	16.8%	16.5%	16.1%	15.9%	15.7%
External	4409.5	3856.0	3631.1	3146	2777	2716	2551	2361	2183	2009
International Agencies	4239.5	3723.0	3507.2	3038	2694	2649	2498	2322	2160	1999
Commercial Loans	170.0	133.0	123.9	108	83	68	53	38	24	9
Other Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
External debt as % GDP	34.9%	25.4%	21.2%	16.8%	12.9%	12.8%	11.4%	9.9%	8.7%	7.6%
Total Public Debt Outstanding	7590.7	7259.8	6732.1	6319.0	6251.0	6261.3	6236.5	6204.6	6170.6	6143.5
As % GDP	60.0%	47.8%	39.3%	33.8%	29.0%	29.6%	27.9%	26.1%	24.6%	23.3%

Source: BPNG and Department of Treasury.
**Includes Temporary Advance Facility

TABLE 13: OTHER MAJOR ASSUMPTIONS UNDERLYING THE BUDGET

	2004 Actual	2005 Actual	2006 Actual	2007 Proj	2008 Proj	2009 Proj	2010 Proj	2011 Proj	2012 Proj	2013 Proj
Inflation										
Average on Average (%)	2.1	1.8	2.4	0.9	10.6	6.1	6.5	4.3	4.0	4.0
Dec on Dec (%)	2.4	4.7	-0.9	3.2	11.1	5.8	5.2	4.1	4.0	4.0
Exchange rate										
Real Exchange Rate Index (2007 = 100)	95.5	97.3	97.9	100.0	118.8	127.5	132.4	134.7	136.7	138.8
Interest rate										
T/Bills (average for the year)	9.0	4.5	5.0	5.0	6.50	7.00	7.00	7.00	7.00	7.00
Inscribed Stock (3 year yield)			6.0	5.7	6.0	6.0	6.0	6.0	6.0	6.0
Mineral Prices										
Gold (US$/oz)	409.2	444.9	604.3	697.0	863.0	600.0	445.0	445.0	445.0	445.0
Copper (US$/lb)	1.30	1.67	3.05	3.23	3.21	1.47	1.60	1.60	1.60	1.60
Oil (Kutubu Crude: US$/barrel)	42.1	53.4	64.3	72.3	102.0	55.0	46.0	46.0	46.0	46.0

Source: Department of Treasury.