



THE INDEPENDENT STATE OF PAPUA NEW GUINEA

2017 NATIONAL BUDGET SPEECH

DELIVERED BY

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INTRODUCTION

Mr Speaker, it is with great honour that I present to this House and the people of Papua New Guinea, the 2017 National Budget. This will be the fifth consecutive budget by the O'Neill led Government and the last budget in this term of Parliament before the national election.

Mr. Speaker, it has been no secret that we are faced with a tight budget. The weakening global situation and low commodity prices has seen Government revenues decline and flatten in the past four years. We have been forced by circumstances to tighten our budgetary situation further through Supplementary Budgets in 2015 and 2016. In doing so we have maintained a conservative course in terms of fiscal sustainability and will be well placed to capitalise on developments when global economic conditions improve.

The message is straight forward, Honourable members. Throughout most of this year, it has been tough for virtually all commodity exporting economies and Papua New Guinea has been no exception.

The ability of the International Financial Institutions and global analysts to forecast trends have been hampered by the uncertainties facing global crude oil and energy markets, uncertain and volatile trends affecting other commodities and the generally unexpected decision by Great Britain to exit from the European Union and the imminent elections in the United States. Other uncertainties related to the treatment of interest rates by the US Federal Reserve and the lingering subdued economic recovery in advanced and emerging economies.

The impact for Papua New Guinea, of course, is that prices of our key export commodities, especially oil, has traded below the 2016 Budget assumption and we are not alone in predicting the extent and duration of the lower oil price. In spite of the revenue constraints facing the Government, efforts have continued to build a better future for our nation and our people. Global trends determine prices for

our export commodities, and therefore we need to be smarter and more pro-active in ways that we manage our economy.

According to the 2016 October World Economic Outlook published by International Monetary Fund, the projections for the World Economy has been revised down and is projected to grow by 3.1 per cent this year.

Mr. Speaker, developments in the World Economy are of great importance to PNG as it determines the demand for our exports and the prices for our key inputs. The IMF is predicting that growth in 2017 will rise to 3.4%. We are hopeful that 2017 may provide a watershed period that points to significant improvement in the global economy, as well as in PNG.

STATE OF THE ECONOMY

Mr. Speaker, I will now discuss the state of the economy.

Mr. Speaker,

- While the medium term outlook for the Papua New Guinea economy remains positive our GDP growth in 2016 has been revised down to 2.0 per cent from the 2016 Budget projection of 4.3 per cent;
- Non-mining GDP growth is also expected to remain positive at 2.5 per cent but lower than the initial projected growth of 3.2 per cent;
- The Exchange rate is projected to weaken against US Dollar by 9.2 per cent and Australian Dollar by 13.4 per cent; and
- Inflation is projected to increase from 5.7 per cent to 6.6 per cent.

Mr. Speaker, the revised growth projection of 2.0 per cent for 2016 is due to time lag effect of the impact on our economy from external factors, such as the El Nino Weather Phenomena. This resulted in an eight-month shutdown of the Ok Tedi copper-gold mine and simultaneous drought and frost conditions to segments of our large agriculture base.

Notable sectors that have experienced a slowdown in growth are, mining & quarrying, manufacturing, and the wholesale & retail trade sectors. Growth projections in these particular sectors have been revised down. The positive medium term outlook in the agriculture, fishery and forestry sectors will slightly complement our modest economic growth projections.

Some of the factors that influenced the downturn in economic activity in 2016 are expected to ease. Foreign exchange imbalance continues to improve as Ok Tedi mine ramps up to full production. The additional foreign exchange proceeds from the Credit Suisse second tranche syndicated loan later this year, along with improved export revenues, should fully resolve the US dollar shortages that have also detracted from overall economic growth. The first tranche of US\$200 million was received from Credit Suisse in August this year.

Honourable Members much of this may continue to provide a continuing sense of uncertainty but, as I mentioned earlier, we are looking forward to steady improvements in the next few years.

Export revenues have stagnated at around K20.8 billion in 2014 and 2015 even though 2015 was the first full year of LNG exports. We are now anticipating significant export growth to commence in 2016. The anticipated decline in LNG export revenues will be more than offset by a projected all-time high in gold export revenues. Additional export revenues are forecast to improve for copper, palm oil, coffee, cocoa and forest products.

Inflation in 2016 is expected to be 6.6 per cent, higher than the 2016 Budget estimate of 5.7 per cent. The increase accounts for the higher than expected 2015 inflation outcome of 6.0 per cent, the gradual depreciation of Kina against our major trading currencies and the anticipation of a gradual recovery in commodity prices.

2017 BUDGET

Mr. Speaker, I now turn to the 2017 Budget, with a fitting theme of, “**Responsible Fiscal Consolidation For Future Growth and Development**”, as we head into an election year.

Mr. Speaker, this Government took office four years ago with one goal in mind. It was determined to lay the foundation for an inclusive and sustainable growth. Since taking office we borrowed to deliver key transformative infrastructural developments, such as Port Moresby City Roads, Lae Wharf and the upgrade of our airports.

However, the collapse in mineral prices in 2012 and the plunge in crude oil price at the end of 2014 were both totally unforeseen circumstances. The confluence of these two factors has made planning and implementation a lot more difficult. The important thing is that we have come through in relatively good shape. Although much attention and considerable criticism has been focussed on public sector debt levels, PNG in fact has among the lowest debt to GDP levels globally and certainly relative to other economies experiencing the level of growth that we have had over the last five or six years.

As the present government’s term in office ends Mr. Speaker, we are confident we have left behind a legacy of economic growth and diversification that will stand us in good stead in the future. The Government’s borrowing program over the past four years has been earmarked at making education accessible to children throughout the length and breadth of the country, having inherited a situation where almost a third of children did not have access to education. Funding for health has been taken to unprecedented levels and big improvements have been made to hospitals in many parts of the country. Much work has taken place on the nation’s infrastructure.

Greatly increased public funding at the Provincial Government and district level has created opportunities for improved service delivery to our rural communities

and district authorities that have used these funds well have a lot to show for the past four years of development.

Mr. Speaker, these are challenging times for PNG, but as a responsible Government we have taken tough decisions, and we have made decisions in this Budget to safeguard our economy but also to better position our economy to respond to positive improvements in the global economy.

In this regards, Mr. Speaker, the 2017 Budget has been framed against a relatively weak global economic environment, relatively moderate domestic economic activity that has been constrained by the after effects of EL Nino and persistent low commodity prices.

The 2017 Budget is set at K12,965.4 million against a revenue envelope of K11,088.8 million. This comprise of K9,182.2 million in tax revenue, K1,045.3 million in grants and K1,245.7 million from other sources of revenue.

Mr. Speaker, the 2017 Budget demonstrates O'Neill-Dion Government decisiveness to move the Government Debt to GDP ratio onto a sustainable path while supporting development over the medium term. This is reflected through:

- enhanced opportunities for our people by building the foundation for the future development in 2017 whilst recognising the need for macroeconomic stability by progressively returning to a balanced budget by 2021.
- continuing to support policy priorities in the education, health, infrastructure, agriculture, tourism and Small and Medium-sized Enterprise sectors.
- facilitating the 2017 General Elections and hosting the APEC Summit in 2018.
- further promoting the efficient and effective implementation of major projects through improved design, scoping, and implementation processes.

- placing more emphasis on monitoring, evaluation and compliance so as to achieve improved development outcomes.
- strengthen efficiency in the public sector.
- Focus on strengthening and improving quality of spending particularly a clear handle on escalating public sector wage bill.

Mr. Speaker, funding is carefully planned to accommodate for high priority expenditure projects that will continue to promote broad based economic growth and adjusting Governments Debt to GDP ratio to return to a balanced budget in 2021.

2017 BUDGET REVENUE

Mr. Speaker, Total Revenue and Grants for 2017 Budget are projected at K11,088.8 million, a slight drop from the 2016 Supplementary Budget estimate of K11,722 million. The weak global economic and low commodity prices has taken a toll on government revenue.

The Government is aware of challenges affecting low levels of promised funding, particularly dividends, from SOEs and as such, endeavours to support SOE rehabilitation and restructuring programs. All key revenue heads are lower than previous Budgets and for obvious reasons. The Personal Income Tax, the single biggest revenue item, has been revised downwards to a total of K2.9 billion in 2017.

TAXATION MEASURES

Mr. Speaker, the 2017 Budget contains significant taxation measures to support the government's efforts towards a gradual fiscal consolidation path to maintain macroeconomic stability, support continued economic growth and employment through improved, broadened and strong revenue base. This measures will raise Government revenue by K620 million in 2017.

I would now like to take the honourable members briefly through the four largest tax measures:

Increased Benefits from Unprocessed Logs through a Progressive Export Duty

The 2017 Budget will reintroduce the progressive log export tax on unprocessed old-growth logs to capture the resource rent of varying log species. This means that logs will now be taxed according to their species value. The progressive log export will enable Papua New Guinea to receive a fair share from exploitation of old-growth logs.

Mr. Speaker, the progressive log export tax is a deliberate policy measure. International commentators have confirmed that the volume of logs leaving our shores is not matching the benefits that should be received. The progressive tax should encourage the establishment of downstream processing facilities and for additional spin-off economic activities.

Increase Alcohol and Tobacco Excise

Mr. Speaker, the consumption of alcohol and tobacco has associated social implications which the government continues to face through increased funding for law and order, manpower, free primary health care, social awareness and education.

More so, the consumption of such goods contributes to poverty and wasteful expenditure. In this vein, the 2017 Budget will increase the alcohol indexation cap from 2.5 per cent to a fixed rate of 5 per cent biannually while the tobacco excise base rates will have a one-off increase.

Mr. Speaker, this initiative is not without risk. There is possibility of people resorting to cheap illicit alcohol and tobacco. As a responsible government, a Task Force will be set up to combat illicit tobacco and alcohol activities in 2017.

Increasing the Taxable Component Of Employer Provided Housing Benefit

The 2017 Budget will adjust prescribed taxable component of the employer provided housing benefit. It will create two additional tiers for Up Market Cost

House & Very High Cost House and will fully tax Offshore employer provided housing. This is to strike a balance between encouraging and supporting employers who provide accommodation to employees, and ensuring fairness to all taxpayers.

Revamped Additional Profits Tax

Mr. Speaker, the final tax measure will revamp the existing Additional Profits Tax (APT) and extend its application across all mining and petroleum sector and not just designated gas projects. The revised APT will be at a single rate of 30 per cent and will trigger a single APT threshold rate of 15 per cent.

The Tax Review Committee and International Monetary Fund (IMF) report indicated that current APT design was below international standards and highly concessional. It was noted that the existing high APT threshold rates were the reason why APT was rarely collected in PNG.

This measure is aimed at achieving progressivity in the tax system to ensure Papua New Guinea derives maximum benefits from its mining and petroleum wealth.

Minor policy measures

Mr. Speaker included in this Budget are other minor tax policy measures which:

- redistributes the gross profits of gaming machines to increase the Government share via Consolidated Revenue Fund (CRF) from 46 per cent to 55 per cent;
- merges bookmakers stamp duty with bookmaker's turnover tax (BTT) and increases BTT to 15 per cent to simplify administration and encourage individual spending in productive areas;
- Increase departure tax from K30 to K114 to maintain real value of departure tax eroded by inflation over time;
- standardises the taxation treatment of corporate income tax, dividends, interest and foreign contractors across all sectors of the economy; and

- repeals double deduction provisions for exploration expenditures.

The remaining tax measures are technical amendments. They are designed to improve the equity, efficiency and simplicity of PNG's tax system. The measures will also help modernise the Internal Revenue Commission and improve its administration.

2017 BUDGET EXPENDITURE

Mr. Speaker, expenditure remains at K12,965.4 million compared with K13,834 million in the recently passed 2016 supplementary Budget after K928 million was cut from the original budget to prevent a budget blow out.

The K1.1 billion reduction in expenditure in 2017 is necessary to maintain overall debt at a sustainable path through a budget deficit of 2.5 percent or K1,875 million. Overall Debt to GDP will remain at 28.8 percent, similar to 2016 Budget, with the risk that a further revenue shortfall could take it over the legislated 30 per cent limit.

The 2017 Budget will maintain the Government's expenditure strategies, as reflected in previous budgets. Close attention will be paid to all Government priority areas including health, education, infrastructure and provincial and District level expenditures.

Mr. Speaker, the Fiscal Framework is based on a Gradual Fiscal Consolidation Path with the aim of achieving a balanced budget just beyond 2021, while keeping Debt at a sustainable level to maintain macroeconomic stability

Mr. Speaker, let me elaborate by Sector:

- The provinces receive K3,605.7 million, or 27.8 per cent of the total budget, which is the largest share of the total budget. Major appropriations include PSIP K220 million, DSIP K890 million, LLGSIP K32.2 million and Ward K61.8 million;
- The administration sector receive K2,732.3 million, or 21.1 per cent of the total budget, which is the second largest share of the budget. Major projects

include hosting of APEC K250 million, 2017 National Elections K400 million, Public Debt Interest Expenditure K1,316.9 million, Superannuation K272.0 million, Public service retrenchment K20 million and Office accommodation K78 million;

- The Health Sector receives the third largest share of the total budget of K1,221.2 million or 9.4 percent. Key expenses include Free Health Care K20 million and Medical Supplies Procurement K160 million;
- The Education sector receives the fourth largest share of K1,162.5 million or 9 per cent. This includes Tuition Fee Free Policy K602 million;
- The Law and order sector receives the fifth largest share of K1,124.01 million or 8.7 per cent. This includes Waigani Court House Complex Redevelopment K80 million, Police Housing Project K2 million, Police Modernisation K15 million and Defence Infrastructure K5 million;
- The Transport Sector receives the sixth largest share of K897.15 million or 6.9 per cent. This is a 12.5 percent reduction from the 2016 supplementary budget;
- The Economic sector is allocated K398.0 million, Community and Culture sector K204.6 million and Utilities sector K223.2 million.

Mr. Speaker, these appropriations reflect the Government's commitment for policy priorities and broad based economic growth. The 2017 Budget does that by making positive long-term choices that will further strengthen our economy and our communities into the future.

2017 BUDGET FINANCING

Mr. Speaker, I now turn to the financing of the 2017 Budget. The Government intends to move the country's Debt to GDP ratio onto a sustainable path while supporting development. The deficit of K1,875 million equates to 2.5 per cent of GDP. The Government Debt profile will be managed strictly using a range of

financing instruments, including the potential issuance of a Sovereign bond to ease pressure on the domestic debt market.

In addition, the Government will continue to work with relevant stakeholders to progress the key recommendations from a review of PNG's Government Bond and Capital Markets by development partners.

COMPLEMENTARY POLICIES

Sovereign Wealth Fund

Mr. Speaker, I am pleased to inform this House that an independent firm has been engaged to carry out a comprehensive executive search in the domestic and international labour market to identify and recommend suitable candidates for appointment as chairman and members of the PNGSWF Board. I expect that the Government will announce the establishment of the SWF Board to manage the Fund in early 2017.

The SWF Board's primary focus in the short term will be to develop a framework and arrangements for Fund Investment and the establishment of the Administrative Secretariat to support its operational and administrative functions. The Administrative Secretariat is expected to be established and operational in 2017 in view of its role and responsibilities.

Public Sector Reform

Mr. Speaker, as you know this is a reform Government. Some of the major Public Sector Reforms initiatives (Legislative and Administrative reforms) are:

- Review of the Public Sector to determine its efficiency and cost effectiveness in terms of service delivery;
- Merging National Departments and Agencies;
- Management of Manpower and Personnel Emolument Ceilings; and
- Superannuation reforms.

These reform initiatives are aimed at reducing inefficiencies, rebase public servicing, and strategically re-align public sector agencies functions and responsibilities to avoid duplication of roles and responsibilities.

Microeconomic Reforms

Mr. Speaker, microeconomic reforms are critical to support sustainable economic growth and diversification. The O'Neill-Dion Government has been embarking on structural reforms in bailing the country out of these challenging times.

This Government has initiated various projects and reform exercises at the micro level aimed at creating an environment conducive for private sector growth. The reforms undertaken focus particularly on improving access to markets and credit, expanding and enhancing financial services, removing impediments to competition, and more importantly, improving the enabling policies, legislative and regulatory environment for the private sector to thrive.

The 2017 year will see the continuation of the existing programs while taking on board new and viable programs consistent with the following objectives:

- encourage State Owned Enterprises (SOEs) efficiency and increase the level of competition within the markets which SOEs operate, with a particular focus on the telecommunication, electricity and transport sectors especially shipping and aviation;
- ensure strong regulatory enforcement of the competition and consumer protection law to ensure markets operate competitively with ethical traders and safeguarding small businesses and consumers against unfair treatment;
- improve the productivity of sectors particularly important to the rural and remote areas of PNG such as tourism and agriculture;
- reduce the cost of doing business by removing regulatory impediments to private sector growth and facilitating the development of small and medium-sized enterprises (SMEs); and

- encourage the operation and the transition of informal economy participants to the formal economy.

SOE Reforms

Mr. Speaker, the State has majority interests in Public Enterprises in PNG. These State Owned Enterprises are expected to operate on commercial terms, similar to private organisations.

The Government will continue to focus on developing policies that promote commercial decision making, greater transparency, good governance, and enhanced competition to support better service delivery to the community as well as to attain higher returns from its investments.

These Government commitments will be promoted through various policy reforms including the On-Lending and Guarantee Policies, Dividend Policy, Community Services Obligation (CSO) Policy, and the Public Private Partnership (PPP) Policy.

CONCLUSION

In conclusion, Honourable Members, the 2017 Budget demonstrates that the O'Neill-Dion Government fiscal measures represent a bold, prudent and sustainable approach to address recent global shocks.

We believe that the 2017 Budget will provide confidence to domestic and international investment communities to continue to invest and be meaningful partners in providing a platform for broad-based economic growth and more opportunities and prosperity for our people.

The message is clear, Mr. Speaker, we cannot spend money we do not have. We cannot borrow beyond our ability to repay. To survive conditions brought about by global trends, we have to maintain realistic policies that will continue to underpin future growth, while ensuring that current revenues are well spent.

Mr. Speaker, in our efforts to return to a balanced budget beyond 2021, we have maintained a significant level of resilience. Broad based developments are occurring within our rural sector which will ensure significantly higher export revenues from palm oil, coffee and cocoa in coming years. Around the end of the decade, production of coffee and cocoa will hit a record 60 tonnes annually from 42,800 tonnes for coffee and 30,900 tonnes for cocoa in 2015.

As part of the path towards fiscal consolidation, a number of corrective measures have been adopted in 2017 Budget. They include:

- establishment of a Revenue Task Force comprising key stakeholders to enforce compliance;
- review and amendment of legislation to divert all non-tax revenue to Consolidated Revenue;
- amalgamation of departments and agencies, freezes on recruitment, and addressing personnel emoluments costs;
- CSTB to stop issuing of conditional contracts; and
- reviewing of all infrastructure contracts.

Mr Speaker, earlier in this address I referred to 2017 as an important transition period with clear signs, particularly on the export front, that we can anticipate significant economic recovery in the latter part of this decade.

PNG bureaucrats have taken full responsibility for drafting of the 2016 Supplementary Budget and the 2017 Budget that I am presenting today.

It is with a sense of pride I can inform this House that this transition has been very successful. The budget team is well used to burning the midnight oil, as they have done in the past few weeks. I commend them for their high level of professionalism and competence in carrying out this task under the direction of Treasury Secretary Dairi Vele.

I know that critics question our ability to manage our own affairs, make our own choices and live with our reality. This government has placed its faith in its own people to manage this economy and I am pleased to say that my colleague Economic Ministers and I and our good staff have repaid that confidence by structuring a very responsible 2017 National Budget for this House to consider.

Mr Speaker, the O'Neill-Dion Government has been quite diligent in framing its economic and fiscal policies and remains committed to steering an independent course that is guided by pragmatism and realistic policies.

Honourable Members, I commend the 2017 National Budget to the House.

Thank you, Mr. Speaker.

A handwritten signature in blue ink, appearing to read 'Pruaitch', with a long horizontal stroke extending to the right.

Hon. Patrick Pruaitch, CMG MP
Treasurer