



# **THE INDEPENDENT STATE OF PAPUA NEW GUINEA**

## **2018 NATIONAL BUDGET SPEECH**

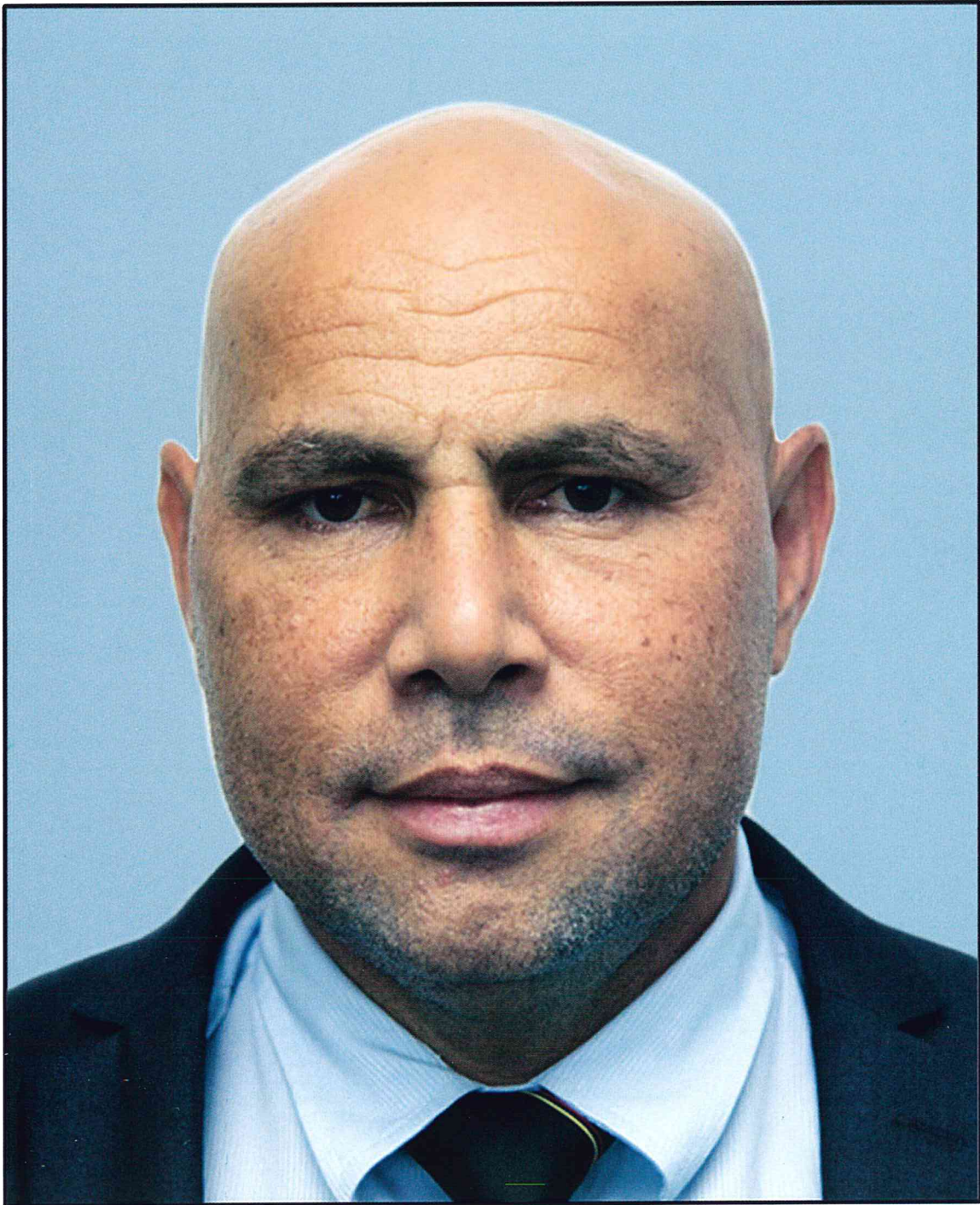
***“Review our Priorities, Refocus our Energies and Reinforce our Strengths”***

**DELIVERED BY**

**HON. CHARLES ABEL, MP  
DEPUTY PRIME MINISTER AND MINISTER FOR TREASURY**

On the Occasion of the Presentation of the 2018 National Budget to Parliament

Tuesday, 28<sup>th</sup> November, 2017



**HON. CHARLES ABEL, MP**  
Deputy Prime Minister & Treasurer

## INTRODUCTION

Mr. Speaker, I move that the Bill now be read a second time.

Mr. Speaker, It is with great honour to stand here as Deputy Prime Minister and Minister for Treasury to present this 2018 National Budget on behalf of our coalition government to the Honourable Members and the people of this great nation.

I'd like to thank our Prime Minister, Coalition Party leaders, Ministers for Planning and Finance, Cabinet, the Government Caucus and the hardworking staff of the Departments of Treasury, Planning and Finance for your efforts and co-operation.

Not so long ago I stood here and delivered the 2017 Supplementary Budget that was Point 1 in the 25 Point 100 Day Plan to kick start the Alotau Accord II of this coalition government. The 2018 Budget our first substantive annual budget, is Point 2 of the 100 Day Plan, and will be another illustration of our intention to deliver on our promise to MAINTAIN FISCAL DISCIPLINE, GROW OUR REVENUES, STRENGTHEN OUR ECONOMIC BASE, IMPROVE GOVERNANCE AND ACT STRATEGICALLY.

Our Government has taken stock following the national elections through a consultative process of engagement with stakeholders from Government, the private sector, development partners and community based organisations. This has been important in helping guide our interventions, and in the spirit of partnership we will continue this open engagement.

Mr. Speaker, following the rapid growth brought about by the commodity boom and the construction of the PNG LNG project the PNG economy has endured a series of economic shocks, commodity prices have fallen and remain relatively low and the severe drought in 2015 added to the difficulties.

A foreign exchange imbalance has developed which has constrained economic growth. Total government revenue has fallen sharply as a share of GDP from 20 percent in 2012 to 13.4 per cent in 2016 and is expected to decline further to below 13 per cent

by the end of 2017. This together with the aggressive fiscal stance of the Government in the last five years, to continue economic stimulus spending after the PNG LNG construction phase and increase investment into enabling infrastructure, education and health, has resulted in larger than anticipated budget deficits. Debt stock as a percentage of GDP has climbed from 23 per cent in 2012 to 32.5 per cent in 2016. This was largely intentional through a series of budgeted fiscal deficits however the economic shocks, combined with growth in the cost of Government operating costs has put pressure on the Governments fiscal strategy. The anticipated windfalls from the PNG LNG Project which largely underwrote this strategy have not yet materialised.

The Supplementary Budget measures are expected to hold the debt to GDP level at similar levels by end 2017, and this is despite further unexpected falls in tax revenue in the final quarters.

In the face of rising debt levels and the resulting domestic financing constraints, the Government has responded to these shocks by cutting discretionary spending, mostly from the capital budget, which has further suppressed economic conditions.

The shocks have had a much greater impact than initially anticipated and continue to have an adverse impact as we end 2017.

Despite these current challenges Mr Speaker, we need to reflect on the massive investments that have gone into infrastructure, education and health services at national and district level over the last five years. We need to maintain these gains and continue to realise the benefits to our people through better access to quality education and health services and jobs and economic opportunities.

As the international economic outlook is becoming a little more positive, Mr. Speaker, we must use the 2018 Budget as an opportunity to continue reforms to make our government systems more efficient and to build a more competitive and broad based economy, with less reliance on imports and primary resource exports, and one that is more resilient to external shocks of commodity price fluctuations or climate change.

Mr. Speaker, I will now turn to the state of the economy before discussing the 100 Day Plan outcomes and then the 2018 National Budget.

## **STATE OF THE ECONOMY**

Mr. Speaker, Papua New Guinea is richly blessed with natural resources, above and below ground and in the oceans. Most of these resources are yet to be developed. There are a number of large and significant projects coming on stream that will continue to underpin our economy. We must however continue to learn from past experiences to fully realise the Vision 2050 and to do it in a smart and responsible way as explained in StaRS. With 8% of the worlds biodiversity, 20% of global tuna stocks, the third largest rainforest and all our hydrocarbon wealth, 800 beautiful cultures, we must manage our population growth and build a smart, self reliant, sustainable economy with participation and benefit to all.

Mr Speaker, According to the International Monetary Fund (IMF), global economic activity is strengthening, with a projected growth of 3.6 per cent in 2017 against 3.2 per cent growth in 2016. The revised forecast reflects a stronger rebound in growth in advanced economies and a lift in the growth prospects for emerging and developing economies.

In 2018, the global economy is projected to grow at 3.7 per cent. This slight improvement from the 2017 projections is driven by the growth impetus emanating from the emerging markets and developing economies (EMDEs). These economies are projected to grow at 4.9 per cent, reflective of stronger projected activity in China and in Europe. The growth forecast for advanced economies remains unchanged, with lower projected growth for the US, Japan and other advanced economies offsetting higher projected growth in the euro area.

Mr. Speaker, while the global economy is showing signs of improvement, the global recovery is incomplete, as growth remains weak in many economies, especially commodity exporting economies. These economies have been hard hit and their adjustment to a sharp step down in foreign exchange earnings continues. PNG is no exception; however our prospects are promising with private sector investment

gaining momentum as potential extractive projects are nearing financial investment decisions.

Mr. Speaker, The domestic economic outlook remains positive. This is despite the commodity market performing below expectations and private sector activities being hampered by the forex imbalance and restrictions on government domestic expenditure in recent years. Our GDP growth in 2017 is still projected at 2.2 per cent in real terms (against 2.7 per cent in the 2017 Supplementary Budget).

Indeed, commodity prices continue to track developments in the global economy. Oil prices have remained around US\$ 50 per barrel for a sustained period although have recently jumped to \$60, and gold prices are lower by 4 per cent, though copper prices are higher by 23 per cent against the 2017 Supplementary Budget projections. Concurrently, lower production from PNG's major oil fields and a further downgrade to log production more than offsets the increase in gold production at Lihir and Simberi, and the Nickel and Cobalt production at Ramu NiCo.

Mr Speaker, inflation is now projected to decrease to 5.9 per cent in 2017 from 6.8 per cent projected at the time of the 2017 Supplementary Budget. The expected inflationary impact of a slightly weaker Kina against the US Dollar and Australian dollar, with depreciation rates of 0.5 per cent and 2.9 per cent respectively, was offset by the full recovery in food production following the 2015 drought and lower aggregate demand for consumer goods and services.

Mr. Speaker, Let me now turn to our expectations for the coming year. In 2018, total real growth is projected at 2.4 per cent, marginally higher than this year. Growth will be driven by the non-mining sectors, feeding off the impetus from APEC related spending across the non-mining sectors and continued improvement in the agriculture, fisheries and forestry sector, which reflects an expected good year for coffee and increased copra and copra oil production due to higher global copra demand.



Over the medium term, the PNG economy is also conservatively expected to grow at an average growth rate of 2.4 per cent driven largely by the non-mining sectors as the investment in these sectors gradually materialises. Importantly, Mr Speaker, the current projection does not take into account major pipeline projects such as the Papua LNG, P'ynang, Wafi-Golpu, Frieda Mine and Solwara 1, which once in the construction phase will provide a significant boost to the entire economy. This maintains some conservatism in our approach as compared to recent budgets. By building the resilience of our economy and our systems, without being overly dependent on these large resource projects, will reduce the impact of volatility from resource projects.

Mr. Speaker, Turning now to inflation, prices of basic goods and services are increasing which impacts the daily lives of our people.

In 2018, inflation is projected at 6.9 per cent, an upward revision of 1.0 percentage point. This reflects the increase in import tariffs and excise rates on specific items in the 2018 Budget, higher spending on goods and services during APEC preparations and Leaders' Summit, and the gradual improvement in domestic economic activity, as well as the gradual improvement in global commodity prices.

Mr. Speaker, Indeed, for 2018, prices of our key commodities are expected to increase modestly from the 2017 levels. The oil price is expected to increase slightly to US\$51 per barrel in line with possible further controls on production from the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC countries and reflecting the expected improvement in global demand. The gold price is also expected to move slightly higher in 2018 due to ongoing safe haven demand resulting from geo-political concerns and potentially higher inflation rates

## **100 DAY PLAN**

Mr Speaker, The 100 Day, 25 Point Plan expires on the 2nd of December and in the light of prevailing circumstances was and is intended to demonstrate proactivity and inspire confidence and kick start the Alotau Accord II by undertaking specific activities around;

MAINTAINING FISCAL DISCIPLINE AND BOOSTING FOREIGN EXCHANGE  
GROWING OUR REVENUES  
STRENGTHENING OUR ECONOMIC BASE IMPROVING  
GOVERNANCE and  
ACTING STRATEGICALLY.

These activities obviously roll into **Points 1 and 2** of the 25 Point Plan which are the 2017 Supplementary and 2018 Budgets.

The intention in Points 1 and 2 was to maintain fiscal discipline in the light of the prevailing difficult circumstances in terms of our budget parameters of a 2.5% fiscal deficit and debt to GDP of 30% so as not to put more stress on government financing and the economy.

A number of measures were undertaken to maintain this discipline but primarily as per **Point 4**, and thanks to the understanding of Honourable Members of this Parliament, the Service Improvement Program was reduced in 2017.

**Point 3** was related to payroll strengthening and the Ospeac (Organisation Staffing and Personnel Emoluments Committee) has been reactivated and is progressing a payroll audit and cleansing exercise and the NID registration requirement as explained by the Minister for Public Service in Parliament. This is in response to the primary cost escalation factor of Government which is the unsustainable growth in personnel emoluments.

**Point 5 was for;**

- i) The drawdown of the balance of the Credit Suisse loan of which two technical requirements will have been met following this budget session enabling the final balance to be drawn.
- ii) To access World Bank and ADB budget support funding for the 2018 budget. This has been achieved following my trip to Washington where the World Bank will provide US\$100m for debt restructuring in 2018 and another \$100m in both 2019 and 2020. The ADB is also providing budget support commencing in 2018 for the



health sector of up to US\$300m commencing in 2018.

These measures provide financial resources at good terms and bring in foreign exchange.

**Point 6** was for;

- i) Oil Search to provide a minimum of 50% of the crude oil needs to the Napanapa Refinery and in Kina terms. This has been achieved through an agreement and is happening.
- ii) Transition to gas powered electricity - the Pom Gas 58MW electricity project has been approved by Cabinet and has commenced construction to provide the cheapest in country power source using our own gas and all sales denominated in Kina. The new power plant will be owned by Oil Search and Kumul Petroleum with shares to be taken up by MRDC. The availability of domestic gas can catalyse other gas powered initiatives.
- iii) Rice production - the rice quota scheme has been delayed and 3 large scale rice projects are being developed with 3 separate private sector partners with potential support in the 2018 budget through the Agriculture Commercialisation Fund.
- iv) The Bank of Papua New Guinea intervention into the forex market with US\$100m is done. The BPNG is also conducting a review of all foreign currency accounts and the obligations of those account holders, particularly resource companies to remit excess funds back to PNG.

**Point 7** for non tax revenue collecting agencies to remit 90% of their revenues to CRF has commenced with some immediate action with specific agencies and will be reinforced by the Public Money Management Regularisation Bill 2017 approved by Cabinet and to be tabled in conjunction with this Budget.

**Points 8 and 10** relate to tax regime reform and this is being managed through the new Medium Term Revenue Strategy, developed in conjunction with the IMF and a new Tax Administration Bill which I will bring shortly. Measures will commence in this budget to tidy up the tax code and the BPNG, IRC, IPA and commercial banks are co-operating to enforce compulsory Tax Identification Number requirement for opening bank accounts. The commercial banks have agreed to provide information to the IRC regarding bank accounts being operated in a business manner for further scrutiny.

Significant funding support is provided in the 2018 budget for both the IRC and Customs to boost capacity against quantified additional revenue collection.

**Point 9** was the establishment of the task forces for the IRC, Lands and the Customs and Illicit Trade. Funding has been provided in the Supplementary Budget and the Attorney General, Labour and Immigration Ministers are leading the Customs and Illicit Trade, Lands Minister the Lands task force and Treasurer the IRC task force.

**Point 11** is for the progress of some significant resource development projects and; Wafi Golpu, PNG LNG expansion, Papua LNG are all on track for early works, pre FEED or FEED in 2018. Western LNG has announced pre FEED works last month.

**Point 12** is for the launch of the new Australian DFAT grant funded projects; the PNG - Australia Economic and Social Infrastructure Program and ANGAU Hospital re-development design are still pending, and the TB Project co funded with the World Bank has had the financing documents executed already.

**Point 13** is the power projects;

- i) the 58 MW Pom Gas project construction has begun.
- ii) the 30MW PNG Biomass Project in Markham with Oil Search is in progress.
- iii) the Ramu 2 180MW Project has had commercial close via a Cabinet decision but is pending financial close due to certain conditions precedent.
- iv) Naoro Brown River Hydro Project is progressing with funding from the World Bank.
- v) Hela Gas power solution is being negotiated with Exxon Mobil and Oil Search. In the meantime funding is provided in this budget to pull the power line from Mendi to Hides to provide the missing power and NBN telecommunications link to access power to the communities from the Ramu Grid and surplus from the Tari existing generator.

**Point 14** is certain high impact projects;

- i) the international submarine cable that the Australian Government has now offered to fund from Sydney to Port Moresby and Port Moresby to Honiara. PNG will own these 100% and 50% respectively and will substantially increase reliability

and lower the cost of data into PNG some 25 times.

- ii) the Pacific Marine Industrial Project has had a new financing agreement signed with the China EXIM Bank.
- iii) the Sepik Plains agriculture project, together with Baiyer Valley and the Central Plains are identified for large scale rice production as described earlier.

**Point 15** is the commencement of the US\$1 billion upgrade of the Highlands Highway of which the Project Management Unit has been established at Works and contracts have been advertised for supervisory contractors. Work will commence in 2018.

**Point 16** is the Gerehu 3B Affordable Housing Pilot Project where 1,762 allotments are being made available free to qualifying citizens. The earthworks has been completed and power and water services are now being constructed. Together with the concessional funding at BSP this will make housing accessible to ordinary Papua New Guineans and drive construction and employment. It can provide an example to duplicate in other centres.

**Point 17** is for the commencement of the new Enga Provincial Hospital construction and Mount Hagen Hospital PPP redevelopment plan in 2018.

**Point 18** is for the ceasing of closed tender financing which Cabinet has approved and the bringing forward the National Procurement Authority Bill which is ready to come back to Cabinet after changes were requested by Cabinet.

**Point 19** requires audited accounts for SOEs and Statutory Authorities by mid 2018. As Treasurer I will be tabling all the reports for the Agencies under my responsibility as soon as they are cleared by Cabinet.

**Point 20** is to have all prescribed Boards appointed. This is underway particularly under the State Enterprises Minister and the Agriculture Minister.

**Point 21** refers to freeing up resource landowner benefits;

- i) the PNG LNG landowners vetting issues are ongoing but royalty payments to the plant site landowners has commenced and it is anticipated to shortly resolve the

pipeline first payments and progress to conclusion the clan vetting at the gas fields.

- ii) the OK Tedi landowner CMCA and Non CMCA have funds held in Trust that have been cleared by the Courts and I am waiting on advice from the Justice Department to authorise some of the pending contracted works against those funds.

**Point 22** proposed to suspend proposed amendments to the Lands Act, the IPA Act, the Agriculture Investment Act, the Agriculture Administration Adjustment Act and the Mineral Resources Authority and the Mining Act to allow further consultation. This has been done.

**Point 23** refers to the National Energy Authority Bill. This should refer to the Petroleum Authority Bill which is being finalised for Parliament.

**Point 24** refers to progressing the Population Policy and funding has been provided in the 2018 budget under the Sustainable Development Program at Planning for this.

**Point 25** refers to Medium Term Development Plan<sup>3</sup> to be published in 2018. This is the 5 year development plan and indicator targets for the government of the day which will incorporate the United Nations Sustainable Development Goals.

## **2018 BUDGET**

Mr. Speaker, I will now turn to the 2018 Budget, with the theme “***Review our Priorities, Refocus our Energies and Reinforce our Strengths***”

Mr. Speaker, The current Government is committed to delivering the Alotau Accord II, as commenced through the 100 Day Plan. This budget is the second component of this Plan. In particular, greater emphasis is given to revenue reforms to arrest the general decline in Government revenue and lift it decisively in 2018 to fund priority expenditures in education, health, infrastructure, agriculture, tourism and SMEs.

This should spur economic growth, generate jobs and empower our people through meaningful engagement in economic activities to better themselves. The

Government will continue to invest in key national infrastructure programs in 2018, particularly, the Highlands Highway, coastal jetties, the missing link roads program, hydro and gas power generation stations, and the international submarine cable project. These are important transformational projects that will reduce the cost of doing business, improve market access for rural farmers, and improve and lower the cost of communications for businesses and consumers.

Promoting structural reforms is another key policy area of this Government. This is focused on reducing the costs of trade, lowering the cost of services such as power and communications, and encouraging local food production to replace imports, and building a more resilient economy with less reliance on the extractive industry. The APEC summit in 2018 will allow PNG to showcase its readiness for enhanced capital and trade flows.

## **2018 FISCAL OUTLOOK: REVENUE AND EXPENDITURE**

### **REVENUE**

Mr. Speaker, the 2018 Budget will mark the first year of the implementation of the new Medium-Term Revenue Strategy 2018-22. Revenue – excluding grants - as a percentage of GDP has declined over the years from around 20 per cent in 2012 to 13 per cent in 2017. A major effort in this revenue strategy is to halt this decline in the revenue to GDP trend and lift revenue levels substantially in 2018 and then stabilize the revenue trend to around 14.0 per cent of GDP over the projection period. This will comprise strengthening the revenue administration agencies to increase compliance, broadening the tax base, some new tax measures and adjustments to the tax mix. It will also mean rethinking our approach to resource project agreements and scrutiny of the arrangements around fisheries and forestry. We need to identify why our GDP growth is not being matched with a corresponding growth in revenue.

The 2018 Budget forecasts an increase in non-tax revenue, through transferring unused balances from revenue collecting agencies to the Consolidated Revenue Fund (CRF) and also transferring 90 per cent of the revenue collections of revenue generating agencies over 2018 to the CRF. The increase in non-tax revenue also includes an increase in dividend payments as a result of an expected improvement in the performance of public corporations.

Mr. Speaker, the 2018 Total Revenue and Grants Budget is projected at K12,730.7 million, an increase of K1,751.5 million or 16.0 per cent, compared to the 2017 Supplementary Budget estimates. A number of the revenue increases are one off in nature and these will be utilised to fund adjustment costs such as clearing outstanding arrears and funding one-off expenditure categories such as APEC. The

Government recognises the folly of locking in higher expenditure patterns over the longer term based on one-off revenue measures that will not be able to be sustained. The increases in the capital budget will be based on the revenue measures that will be able to be sustained.

In this respect, with the new revenue strategy, major tax head contributions to revenue are expected to increase above 2017 levels with Personal Income Tax collections expected to reach K3.2 billion; Company Tax K1.9 billion; Mining & Petroleum Tax K179 million; Gaming Machine Tax K174.4 million; Dividend Withholding Tax K137.4 million and Interest Withholding Tax K84.2 million. For the Indirect Taxes, GST is expected to reach K1.9 billion, Excise Duty K782.3 million, Import Excise K395.1 million, Export Tax K330 million and Import Duties K296.1 millions.

Non-Tax Revenues are expected to be substantially higher comprising Fees and Charges which are expected to reach K175.2 million. Dividends from state owned enterprises and mining and petroleum projects which are expected to reach K1.3 billion. The breakup of the dividends are: National Fisheries Authority K400 million, Kumul Petroleum Holding Limited K300 million, Ok Tedi K200 million, Bank of PNG K150 million, Kumul Consolidated Holdings K100 million, National Gaming Control Board K75 million and Motor Vehicle Insurance Limited K25 m.

In addition to this, the newly introduced 90:10 Statutory Transfer rule will generate an additional K565 million comprising one off receipts from the National Fisheries Authority of K400 million, National Gaming Control Board K75 m, Kumul Consolidated Holding K40 million, Mineral Resource Authority K30 million, National Maritime Safety Authority K10 million and the Conservation and Environment Protection Authority K10 million.



Grants from donor agencies are expected to total K1,024.6 million in 2018. Donor Grants are subjected to movements in the exchange rates and policies of donors.

## **TAXATION MEASURES**

Mr. Speaker, consistent with the new Medium Term Revenue Strategy (MTRS) and guided by the Alotau Accord II and the Government's 100 Day Plan, the 2018 Budget introduces a number of revenue policy measures. These measures are aimed at improving revenue collections through greater compliance, broadening the tax base to increase revenue more equitably and efficiently and making tax administration simpler and more effective. I would now like to present the Honourable Members with the five major revenue measures:

### **1. Strengthening Revenue Raising agencies**

Mr. Speaker, while improving revenue policy has the potential to raise revenue, increased revenue collection depends very much on the effectiveness and efficiency of the revenue administration. The Government's focus for 2018 is to strengthen the revenue raising agencies - IRC and Customs - through the establishment of a large tax payer office to focus on increased compliance of large tax payers for IRC and for PNG Customs to engineer a concerted lift in compliance and collections.

In this space, Mr. Speaker, I would encourage the Hon. Governors to work with the Provincial Tax Office to establish an Interim Compliance task force to improve GST collections as I understand there is significant GST compliance issues out in the provinces. This measure will assist provincial governments with increased funds as 60 per cent of the net GST collection eventually goes back to the provinces.

In 2018, Mr Speaker, in partnership with Industry Associations, we will operationalise a Revenue Taskforce, as noted earlier, this will be overseen by the Office of the Attorney General. The investigative focus will be on disrupting organised syndicates through prosecutions and asset/ revenue collection.

## **2. Removal of the Training Levy and Double Deduction for Training**

The 2018 Budget removes the training levy and double deduction for training incentives as they have outlived their purpose. In this modern commercial environment companies already have an incentive to train and up-skill their employees to add value to their businesses to remain competitive.

## **3. Reforms to Import Tariff and Excise on Diesel**

Mr. Speaker, this budget suspends the last phase of the current tariff reduction program (TRP), increases import tariffs on refined petroleum products and other imported products to strengthen and support domestic manufacturing.

There has been significant concerns raised by PNG manufacturers on the stiff competition coming from imported goods. Hence, the Government, in an effort to support employment through local manufacturers increased import tariffs on certain items in the 2017 Supplementary Budget.

This budget, continues to support local manufactures by a further moderate increase to import tariff rates on items that are produced in PNG and items that have significant health risks, while some basic items that are not produced in PNG are set to zero.

Furthermore, the Government is concerned that the existing Import Parity Pricing model is largely benefiting importers of refined petroleum products to make excessive profits from imported petroleum products. In response, the Customs Tariff Rate for Diesel and Petrol is set at K0.10 per litre.

This budget also introduces a further increase to diesel excise to 23 toea from 10 toea to align the rates more with petrol excise. There is merit in this alignment because both diesel and petrol vehicles are contributing to the overall wear and tear of the road network and it is important that all road users pay their fair share of excise.

#### **4. Realign export duty of unprocessed old-growth logs to capture resource rents at varying log species**

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.

In addition, Mr. Speaker, there are some areas that have high valued log species while others may have low value species logs and therefore the taxation treatment is unfair. Furthermore, it is a known that most logging companies in PNG are in prolonged tax loss situations, hence they do not pay corporate income taxes.

#### **5. Tax Administration Bill.**

Mr. Speaker, before I talk about the other minor policy tax measures, I would like to inform that this Budget also introduces measures to simplify tax administration through the announcement of a Tax Administration Bill. The Bill sets out common procedures for the main taxes, gives greater consistency between the administrative rules for the different taxes and more certainty on taxpayers' obligations and rights. This is again a milestone achievement in the Alotau Accord II and first step towards simplifying and modernising tax regime consistent with the 100 Day Plan.

Mr. Speaker, the 2018 Budget also introduces other minor tax policy measures to increase efficiency of the tax system and also to enhance tax compliance through clarifying the taxation law and simplifying tax administrative procedures and processes for the benefit of tax administration and taxpayers.

Some examples of amendments that are introduced to clarify the taxation law relate to defining terms 'primary production' as applicable in the agriculture sector' and 'resources' as applicable in the mining and petroleum sector whilst other minor amendments to introduce efficiency in the tax system relate to increasing tax thresholds for sending money overseas and allowing the Commissioner General to declare landowner resource trusts.

The amendments to increase tax compliance relate to 'pay now and litigate later' policy, introducing a specific bribery offence provision to make tax administration officials more accountable and transparent and making registering taxpayer identification numbers as a legal requirement.

Mr. Speaker, this Budget will also introduce a number of amendments to modify the 2017 Budget measures. Drafting issues led to unintended consequences and impinged upon other legislation, with possible impacts upon some commercial agreements and may have deflected the intended policy objectives. This budget will clarify drafting structures to give full effect to the policy intent of the measures.

In relation to termination benefits for employees, Mr Speaker, the tax treatment has been amended so rather than being taxed at their respective top marginal tax rate the treatment will be the same as superannuation payouts.

## **EXPENDITURE**

Mr. Speaker, on the other side of the ledger, Total Government Expenses for the 2018 Budget is also being prepared in a difficult fiscal environment and a number of structural impediments around the management of personnel emoluments (PE) and goods and services will need to be addressed.

The intention is to reduce total expenditure as a percentage of GDP from 18.4% in 2018 to 16% by 2022.

To improve expenditure productivity, the 2018 Budget will focus initially on areas that have, in the past, exceeded expenditure appropriations which by necessity forced substantial reductions in the capital and development budget to meet financing and other constraints. This led to very low productivity in service delivery and public investment levels – both key to lifting economic growth and improving the lives of the people of PNG.

However, the Government is mindful of the fact that the projected revenue increase in 2018 is partly driven by one-off non-tax gains; those revenues will be used to clear arrears and complete on-going projects and reforms to ensure that they do not add pressure on the fiscal space over the medium term.

The 2018 Budget expenditure envelope is set at K14,717.9 million. This is comprised of K10,074.0 million in operational expenditure and K4,643.9 million in capital expenditure. Compared to the 2017 Supplementary Budget estimates, the Budget envelope is projected to increase by K1,862.3 million (or by 14.5 per cent) with some of the increase in expenditure being allocated to the major task of clearing arrears and, therefore, will not be required to be sustained over the subsequent projection period.

Total Income including Grants in the 2018 Budget is estimated to be K12,730.7 million and with Total Expenses and Capital Expenditure appropriations set at K14,717.9 million, this results in a financing requirement of K1,987.3 million, which will maintain the deficit at 2.5 per cent of GDP – the same rate as in the 2017 Supplementary and 2017 Budget.

Importantly, within expenditure envelope, expenditure on Personal Emoluments (PE) has been reduced by 3.2 per cent and grants reduced by 16.7 per cent. These reductions have been more than offset by a modest increase in goods and services appropriations, up by 5.2 per cent; public debt interest up by 14.4 per cent and capital expenditure up by 59 per cent.

Despite a modest reduction in 2018 appropriations, PE expenditures remain significant and the actions in this Budget will bring control over this category in 2018 and over the medium term. This item will be on a decreasing trend from 6 per cent of GDP to 4.5 per cent by 2022. Government's drive is to clear accumulated arrears, while other operational expense allocations such as travel and subsistence have been reduced significantly. The increase in public debt interest reflects higher debt levels and the shortening of the average maturity of the Treasury bill portfolio.

The increase in the capital budget from 28 per cent of non-resource revenue to 38 per cent by 2022 reflects the Government's decentralisation objectives manifested in full funding for the Services Improvement Programs (SIPs) and additional appropriations to support public sector investments, as well as leveraging counterpart funding to increase the drawdown of donor loan funded projects.

Mr. Speaker, a large portion of the 2018 Budget is appropriated to the Provinces through the SIPs and GST distributions, followed by the Administration Sector, Debt Service, Health, Education and Law and Justice sectors.

## **DECENTRALISATION**

This Government is about distributing fiscal resources in a way that facilitates essential services reaching our people. In this Budget, the provincial sector receives K3,925.0 million or 26.7 per cent of the total budget, which is the largest share of the total budget. Major appropriations include PSIP K220 million, DSIP K890 million and Ward SIPs K64.4 million.

## **ECONOMIC GROWTH**

In 2018, this Sector has seen the highest increase from K385.7 million in 2017 Supplementary Budget to K665.9 million or a 72 per cent increase. Much of the increase is captured in the capital component with an increase of over 140 per cent.

Mr. Speaker, this reflects the Government's commitment towards boosting the growth of the economy. For example, in the 2018 Budget, the Government has maintained its support for the renewable resource sector by allocating a significant amount of funds to the ongoing activities such as the Productive Partnership in Agriculture Program (Additional), National Cattle Breeding Farm (PPP), Freight subsidy for cocoa and coffee, Strategic Defence Against Coffee Berry Borer and the Regional Cocoa Nurseries Project. An agriculture commercialisation fund is established at K100m and further funding provided to the National Development Bank at K100m for SME lending. The Peoples Microbank receives K20m. K50m is provided for Industrial Centre development particularly to support SME incubation centres. Tourism will benefit for the first time from a loan from the World Bank of \$US20m which will be partially drawn in 2018 with counterpart funding from GoPNG of K8m.

## **EDUCATION**

Mr. Speaker, the education sector is key to delivering quality in primary, secondary and tertiary education through the Department of Education, Department of Higher Education, Research, Science and Technology, and the national universities and colleges.



A total of K1,293.4 million has been allocated to the Education Sector in 2018 which is 8.8 per cent of the total Budget and is an increase of 13.3 per cent from the 2017 Supplementary Budget. Of the total Budget, K1,025.7 million is operational and K267.7 million is capital expenditure. The Tuition Fee Free (TFF) policy is maintained at K602 million.

Mr. Speaker, current investment priorities include: investment in community education initiatives; nursing education and training; and teacher's, technical and business colleges; establishment of Polytechnic and national universities; and to complete the transition from Outcome-based education to Standard-based Education.

Mr. Speaker, the focus on Technical and Vocational Education Training (TVET) is to establish the Centre of Excellence to produce the required trade skills to meet industry needs and empower youths to engage in private sector activity. This will ultimately contribute to an increase in productivity of human capital and greater participation in the economy.

## **HEALTH**

In the 2018 Budget, the Health Sector is allocated K1,505.9 million which is 10.2 per cent of the total Budget and is an increase of 14.0 per cent from the 2017 Supplementary Budget. From the total Budget, K1,044.3 million is allocated for operational and K461.7 million for capital expenditures. K266.1 million has been allocated for medical supplies, procurement and distribution processes.

This government remains focused on delivering an efficient and effective health system that achieves internationally acceptable standards of health services that are accessible by the people across the country. The key priorities of the sector are noted to have made significant progress in achieving the health targets and improving indicators over the recent years, and this should continue to be supported by the National Government and development partners.

The current focus on provincial hospitals should be complemented by efforts from provinces with SIPs through the PHAs to ensure that basic infrastructure in districts

and LLGs exist and is adequately funded through the operational component. Provinces and districts should fund the majority of the infrastructure needs at the provincial, district, and the LLG levels.

Financing of the Health Sector has increased significantly over the last five years and a focus on improving the infrastructure of the National and Regional Referral Hospitals and Provincial Hospitals are critical national functions.

The Port Moresby Heart and Lifestyle Diseases Institute receives K30m as does the ANGAU Cancer Unit. A new program for District Hospital Development gets K50m.

## **TRANSPORT**

Mr. Speaker, programs and projects implemented in 2017 will continue for the year 2018. These transport programs include the continuous investment on upgrading and maintenance of the National Priority Roads plus construction of missing links, district commodity roads; and the Civil Aviation Investment Development Program (CADIP). In the medium term, roads, bridges, ports, and airports/airstrips will be targeted toward the untapped economic potential areas to stimulate economic growth.

In 2018, the Transport Sector will receive K937.1 million which is 2.1 per cent higher than the 2017 Supplementary Budget and makes up 6.4 per cent of the 2018 Budget. This consists of K642.3 million in capital and K294.9 million in operational expenditure.

The ADB funded Highlands Highway rehabilitation program commences in 2018, Rural Jetties gets K20m, Oil Palm Roads K15m, the Rural Airstrips Authority gets K6m.

## **APEC**

Since 2014 a significant amount of funds has been invested in this event. In 2018, the Government has allocated K300.0 million, with much of it being geared towards the administrative and logistics preparation.

Mr. Speaker, I'd also like to point out that the Department of Community Development along with K25m from Australian DFAT is getting K40m primarily for

programs associated with Gender equality, Gender Based Violence and awareness on Sorcery related violence, TB and HIV.

## **2018 FINANCING & PUBLIC DEBT**

Mr. Speaker, the estimated net budget financing requirement for 2018 is K1,987.2 million. Commensurate with the new MTDS 2018-22, this budget deficit is projected to be financed through external and domestic sources comprising K1,613.4 million from external sources and K373.8 million from domestic sources.

Net domestic financing will comprise K30.2 million from Treasury Bills and K343.6 million from Treasury Bonds.

The external financing will be funded from concessionary budget support from the Asian Development Bank and the World Bank, commercial financing through the inaugural USD bond program and some minor external loans, and the remaining balance of K 337.4 million (in net terms) from concessional donor program loans.

Mr. Speaker, the financing requirement for 2018 will result in total government debt reaching K25,807.6 million by end 2018, equivalent to 32.2 per cent of GDP. By end-2018 the composition of total debt is projected to comprise of domestic debt of 22.1 per cent of GDP or K17,723 million and external debt amounting to 10.1 per cent of GDP or K8,084 million, predominantly loans from multilateral, bilateral and commercial creditors.

Mr. Speaker, with adverse revenue trends being halted and expenditures trends being rebalanced and placed on a declining trend trajectory, the 2018 fiscal deficit or net borrowing requirement is projected to be K1,987.2 million or 2.5 per cent of GDP. This translates into a debt to GDP ratio of 32.2 per cent which is within the 30-35 per cent boundaries prescribed in the *2017 Amended Fiscal Responsibility Act (FRA)*, which is consistent with a declining medium term debt target of 30 per cent by 2022. This approach is supporting the adjustment to a new fiscal and economic reality while ensuring the continuous delivery of services.

In addition, the Government is required to target a zero-average annual non-resource primary balance over the medium term.

Regarding the SWF, although it is yet to be operationalised, it remains a critical part of our medium term strategy in building the country's economic resilience and mitigating the impact of commodity price movements. Progress will be made towards its operationalisation in 2018 to increase our readiness should enhanced fiscal revenues materialise.

Government, over the medium term, starting in 2018 will promote value for money and efficiency through a number of reforms including:

- Improving the management of personnel emoluments, through the work of OSPEAC;
- Reducing leakages by implementing the amalgamation programme, and reforming procurement;
- Improving the selection of capital projects by creating the committee led by Planning to evaluate financial and economic impacts of each project;
- Merging National Departments and Agencies;
- Management of Manpower and Personnel Emoluments Ceilings; and
- Industrial Pay Fixation Agreements.

Some of these reform initiatives are aimed at reducing inefficiencies, rebasing the size and function of the public service, and re-aligning public sector agency functions and responsibilities to avoid duplication of roles and responsibilities.

On the back on the upcoming APEC meetings, PNG will embark on a number of structural reforms, as the Government will continue to partner with key stakeholders in removing barriers to doing business and investment in PNG in specific sectors such as aviation, communication and SMEs. Central to this set of reforms are the recommendations captured in the Consumer and Competition Framework Review and the Financial Services Sector Review which will be endorsed and implemented in 2018. Also, the Department of Treasury and Bank of PNG are focusing their efforts on improving access to finance through micro-finance, SMEs finance and greater financing inclusion programmes.

## ECONOMIC AND FISCAL RISKS

Mr. Speaker, although the global economy has improved, inherent uncertainties in this recovery climate will still pose a risk for the PNG economy, particularly if commodity prices fall below current levels.

On the domestic front, the noticeable imbalance in the foreign currency market also poses a considerable risk to economic activity and the inflation outlook. Greater coordination between fiscal and monetary policies is needed, as well as a preparedness to inject the required amount of foreign currency into the system to ease market demands. In this respect the Government's 100 Days Plan has prompted the BPNG to inject US\$100 million over the period of the Plan to ease foreign exchange pressures.

Natural phenomena such as weather-related issues and landowner issues and other events can substantially affect output and government revenue, notably through their impact on extractive projects and agricultural production.

Mr Speaker, a number of fiscal risks continue to be present and have become more critical over recent years including:

- slower than expected implementation of large investment projects could impact adversely on overall economic growth and anticipated revenue growth;
- failure to reverse the declining trends in revenue collections and failure to implement reform plans in particular on non-tax revenue that will adversely affect the 2018 budget and the medium term;
- failure to control rigid expenditure categories such as personnel emoluments will prevent fiscal space from being created to support more efficient public investment levels; and
- failure to address and control the level of arrears, particularly at year end tend to add to fiscal risk which undermines budget execution and debt management.

Finally, Mr Speaker, heavy reliance on domestic borrowing with an increasingly short duration gives rise to rollover risks and potentially volatile interest rates and interest costs to the Budget.

Nevertheless, we are confident that our Medium Term Debt Strategy with a renewed focus on shifting the portfolio towards external borrowing will mitigate these risks.

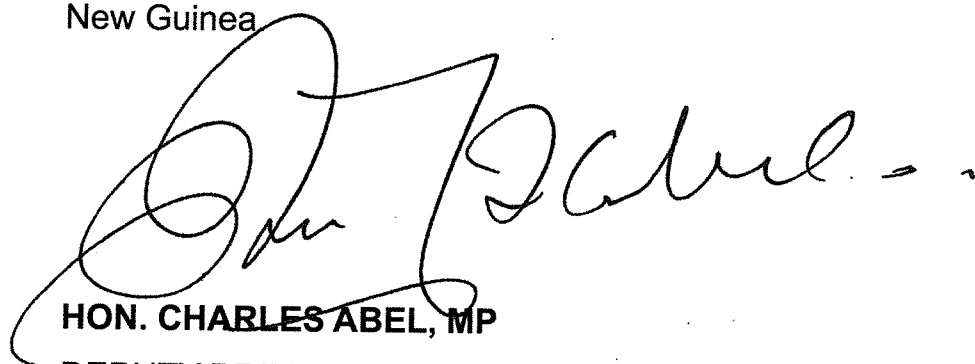
## CONCLUSION

Overall, the 2018 Budget is a forthright step towards strengthening the resilience of the PNG economy to withstand future economic shocks. It lays the groundwork for fiscal consolidation and it will reignite the economic growth momentum and boost optimism for the future.

Importantly, it will shift focus to generating jobs and business opportunities for our people in agriculture, tourism and SMEs. And it will provide the platform to showcase the best of PNG to the world at the upcoming APEC summit.

Mr Speaker, it is an opportunity to ***“Review our Priorities, Refocus our Energies and Reinforce our Strengths”***

I commend the 2018 Budget to the Honourable Members and to the people of Papua New Guinea

A large, stylized handwritten signature in black ink, appearing to read 'Hon. Charles Abel', is written over the printed name and title.

HON. CHARLES ABEL, MP

DEPUTY PRIME MINISTER AND MINISTER FOR TREASURY