



INDEPENDENT STATE OF PAPUA NEW GUINEA

2022 Budget Strategy Paper

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Treasurer

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I. PURPOSE

The publication of the Budget Strategy Paper (BSP) is consistent with the Papua New Guinea's *Fiscal Responsibility Act (FRA) 2006*. The 2022 BSP provides the public with the revised fiscal framework for the medium term, under which, the framework of the 2022 Budget have been designed. In the subsequent sections, it discusses further details of the key elements of the 2022 Budget strategy.

The 2022 BSP will be the second produced by the Government led by Prime Minister, Hon. James Marape and the Coalition Government. The 2022 BSP draws from the high-level policy direction of the Treasurer, Hon. Ian Ling Stuckey (CMG, MP), after consultations with the National Executive Committee (NEC), the Budget Management Committee (BMC) and representatives of the IMF's Staff Monitored Program (SMP).

The 2022 BSP is released shortly after the 2021 MYEFO as set out in the *FRA*. The delay is attributed to the COVID-19 pandemic, which affected other related work programs, causing delay in the release of the 2022 BSP.

The 2022 Budget strategy will continue to be guided by the doctrines of development espoused by the Five (5) National Goals and Directive Principles, the National Strategy of Responsible Sustainable Development (StaRS), and Papua New Guinea's commitment to the 17 United Nations Sustainable Development Goals (SDGs), that have been captured in the development principles defined by the Vision 2050, and the Development Strategic Plan 2030, as prescribed in the Medium Term Development Plans (MTDPs) II and III. In 2020, the Government had put forward the '*Loloata Commitment*' as a rescue and reconstruction strategy that began with a fiscal re-adjustment and a revised Medium Term Fiscal Strategy (MTFS) 2020-2024.

In 2022, the MTFS outlook will be revised to 2022-2027 guided by the principles of '*spend the money we have more wisely*', '*raise the revenues more fairly*' and '*finance the debt more cheaply*' will remain. This is a longer time frame that required under the *FRA*, and has been done to help inform decision making over the full life of the next Parliament. The strategy continues the path of budget repair and reconstruction taking into account the impact of the COVID-19 pandemic.

Supporting the MTFS 2022-2026 will be an updated *Medium Term Debt Strategy (MTdS)* and the *Medium Term Revenue Strategy (MTRS)*; all working in tandem towards the implementation of the Government's reform agenda.

The broad objectives of the budget repair and reconstruction programme under the 2022 Budget strategy, consistent with the 2021 Budget, is to provide the platform for fiscal consolidation whilst at the same time continuing with strategic capital formation necessary to continue to enable the private sector and community at large to grow the economy, in particular the non-resource sector, expand the tax base and enhance the cost effectiveness of the delivery of essential services.

The budget will be built around the 10 principles:

- spend the money we have more wisely,
- raise the revenues more fairly,
- finance the debt more cheaply,
- leverage friendly international support more intelligently,
- focus on growth in the agriculture, forestry and fishing sector, SMEs and the informal economy,
- distribute resource benefits more equitably,

- stimulate non-resource growth back to at least 5.0 per cent annually,
- comprehensive Government SOE reform program for cheaper energy, internet and water,
- getting foreign exchange flowing more freely, and
- create at least 10,000 jobs annually.

II. WORLD AND DOMESTIC ECONOMIC OUTLOOK

a. World Economic Outlook

The global economy continues to recover driven by the advanced economy. A strengthening recovery in advanced economy is offsetting weaker growth across emerging and developing economies.

The International Monetary Fund (IMF) in its latest World Economic Outlook (WEO) update for July 2021 reported that global growth is projected to grow by 6.0 per cent in 2021 and 4.9 per cent in 2022. While the 2021 global forecast is unchanged, the 2022 forecast is revised up by 0.5 percentage points, from April 2021 WEO. Growth will be supported by the advanced economies who are expected to see further normalisation underpinned by the expectation that vaccine will be fully rolled out at the end of 2021 coupled with the additional fiscal support in the United States (US), with associated spill overs to the global economy.

In the advanced economies, growth is projected to increase by 5.6 per cent in 2021, 0.5 percentage points higher than the 5.1 per cent projected in the April WEO. This growth is underpinned by the significantly improved economic outlook for the US economy, projected to grow by 7.0 per cent reflecting the impact of the anticipated legislation of additional fiscal support boosting infrastructure investment and consumer spending. The Biden Administration's US\$1.9 trillion fiscal stimulus is expected to further boost GDP over 2021-2022 with significant spill over to the US main trading partners. Moreover, the swift access to vaccine by most people in advanced countries and the adaptation to pandemic life is boosting the global growth prospects.

Growth among Emerging Markets and Developing Economies (EMDEs) is projected to grow by 6.3 per cent, 0.4 percentage points lower than 6.7 per cent projected in April WEO. The downward revision is largely driven by downgrade in growth in the emerging Asia economies especially in India following the severe second wave of the COVID-19 pandemic. Overall, the growth will be driven largely by China. China is projected to grow by a solid 8.1 per cent driven by favourable external demand, especially, through a spill over from the US fiscal stimulus. Other EMDEs, especially, commodity export countries are also expected to grow, driven by higher commodity prices. However, the recovery of many countries are hindered by resurgence of the COVID-19 and the uneven rollout of the vaccination.

There are, however, some significant uncertainties surrounding the recovery and is primarily related to the prospects of EMDEs. Slower than anticipated vaccine rollout would allow the virus to mutate further. Financial condition could tighten rapidly, for example if inflation rose rapidly than expected in advanced economies causing central banks to tighten monetary policy especially increasing the long-term interest rate which will adversely affect EMDEs who have high debts and large financial needs. Most of the EMDEs are lagging in vaccine rollout and the monetary tightening would be a double hit to economy slowing the recovery pace and dragging the global growth below.

Finally, social unrest, geopolitical and trade tension and weather-related natural disasters (El Nino, Earthquake, drought, etc.) has increased in intensity and frequency could further weigh on the recovery.

b. 2022 Domestic Economic Outlook

Real non-resource sector growth is projected at 3.3 per cent for 2022, a 0.6 percentage point lower than the 3.9 per cent growth in 2021. The AFF sector is projected to grow by 2.9 per cent, a slowdown from 4.1 per cent growth estimated in 2021, and is driven by the normal year of production domestically. Furthermore, the general persistent constraint in the business conditions due to foreign exchange legacy issues coupled with the deteriorating and unreliable infrastructure would still impede growth in the sector. However, the non-resource sectors are also expected to be supported by election related spending.

The Transport, Storage and Communication, and Accommodation and Food Sectors are projected to grow by 6.0 per cent and 6.1 per cent, respectively, in 2022. These sectors were hit hard by the COVID-19 pandemic but now are projected to slowly recover driven by recovery in travel and leisure activities, the resumption of the Porgera mine and election related activities. However, the downside risk is the COVID-19 pandemic continues, if people continue to decide not to travel due to health risks.

The Construction sector is projected to grow at 4.0 per cent and mostly to be supported by the Government of PNG capital expenditure projects associated with the Government's signature policy of Connect PNG.

Growth in real resource GDP is projected at 8.5 per cent for 2022. The Mining and Quarrying sector is projected to grow by 28.6 per cent reflecting increased production as Porgera mine resumes operations in the second quarter following agreement in 2021, and there is no disruption to Ok Tedi and other mines. The oil and gas sector is projected to contract by - 0.2 per cent

Over the medium term, the PNG non-resource economy is expected to grow by 4 percent then rising to 5 percent in the outer years as the impact of better policies are felt through the government's economic reform project. In addition, the non-resource GDP is not expected to fully recover to pre-COVID-19 level. Based on advice from the IMF average of levels of COVID-19 damage for similar countries, the non-resource GDP is expected to continue at around 7 percent below pre-COVID trend level. As more information comes available the COVID-19 economic scarring will be reviewed. The forward projections are conservative as they follow international best practice in not including any new resource projects until Final Investment Decision (FID). This is a forecasting assumption and allows for considerable upside from these projects as they come onstream. This conservative assumption means resource sector nominal growth is very low, reflecting only a continuation of current projects, therefore pulling down overall estimated growth to around 3.2 percent in 2022.

Presented below are the assumptions on economic parameters for the medium term. The major economic parameters (see table 2) such as GDP is projected to recover in real terms supported by the growth in the non-mining GDP sector of the economy.

For inflation, average-on-average in 2022 is projected at 5.6 per cent. The driving factors behind the price increases are mainly attributed to the rebound in economic activities translating to increase in the domestic demand for goods and services, rebound in oil prices and a stronger Australian inflation outlook (major source of PNG's imports). The medium term projections have the inflation figures trending towards PNG's long term average inflation rate.

On commodity front, oil prices are projected to decrease only slightly from US\$65.0 per barrel in 2021 to US\$63.0 per barrel in 2022 reflecting impact of higher inventories on prices. The recovery in prices from 2020 could lead to OPEC+ increasing production and or non-OPEC oil field, particularly in US, becoming economically viable again and resume production. The increased US output will impact future prices.

PNG's precious metals in particular gold prices is expected to increase in 2022 further gaining on the heightened uncertainty globally, however, downside risk is eminent with regards to the prospects of containment of the COVID-19 pandemic and stronger global economic recovery reducing Gold's safe haven demand. For base metals, copper price is expected to further increase in 2022 maintaining its strong performance in 2021 as a result of increasing demand amid lower supply.

Table 2: Economic Parameters (2020-2027)

	2019 Actual	2020 Estimate	2021 Estimate	2022 Proj	2023 Proj	2024 Proj	2025 Proj	2026 Proj	2027 Proj
Economic Growth									
Total Real GDP (%)	4.5	-3.5	1.7	4.8	4.3	2.3	2.7	3.6	3.7
Non-Mining Real GDP (%)	1.6	-1.2	3.9	3.8	4.4	4.1	3.9	5.0	5.0
Total Nominal GDP (%)	5.6	1.8	9.1	8.5	8.5	6.3	6.7	6.9	7.8
Inflation									
Average on Average (%)	3.6	4.9	5.2	5.6	5.3	5.2	5.1	5.0	5.0
Decade on Dec (%)	2.7	5.1	7.5	4.6	4.6	4.7	4.0	4.0	4.0
Exchange Rate									
Real Exchange Rate Index (2007=)	130.1	132.0	130.0	129.0	130.4	130.4	130.4	130.4	130.4
Interest Rate									
Kina Facility Rate (KFR)	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Inscribed Stock (3 year yield)	9.0	9.0	9.8	9.8	9.8	9.8	9.8	9.8	9.8
Mineral Prices									
Gold (US\$/oz)	1,392.2	1,769.7	1,802.7	1,854.2	1,868.7	1,898.9	1,940.4	1,970.8	1,970.8
Copper (US\$/tonne)	6,006.4	6,169.5	9,191.8	9,052.7	8,935.7	8,776.4	8,631.6	8,596.4	8,596.4
Oil (Kutubu Crude: US\$/barrel)	57.0	39.5	64.8	63.1	59.9	57.8	56.5	55.8	55.8
LNG (US\$/thousand cubic feet)	10.6	8.3	9.1	8.7	8.4	8.1	7.9	7.7	7.7
Condensate (US\$/barrel)	57.0	39.5	64.8	63.1	59.9	57.8	56.5	55.8	55.8
Nickel (US\$/tonne)	10,960.5	10,638.7	18,023.5	18,432.4	18,573.3	18,711.3	18,841.6	18,968.7	18,968.7
Cobalt (US\$/tonne)	22,836.4	21,482.7	47,729.4	47,870.3	48,236.4	48,594.7	48,933.2	49,237.2	49,237.2

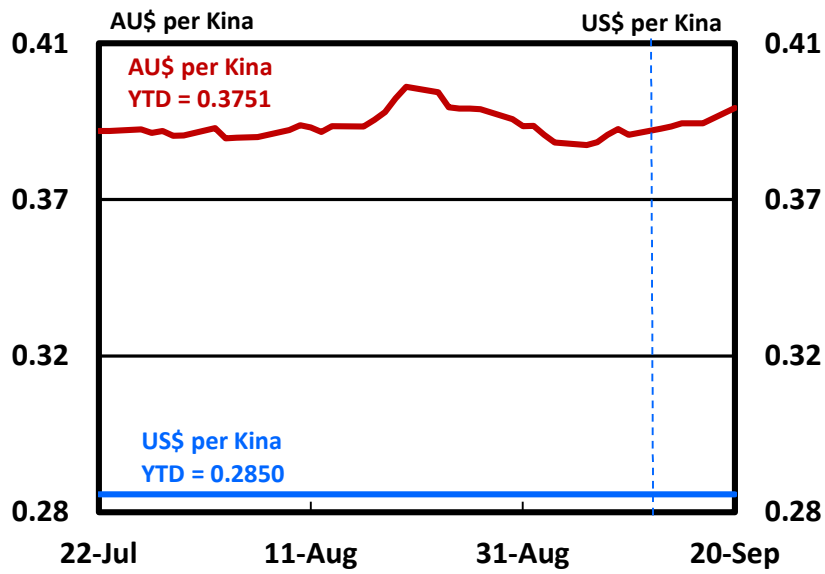
Source: Department of Treasury

Since the release of the Monetary Policy Statement (MPS) in March by the Bank of PNG (BPNG), the Kina has remained unchanged against the US dollar, maintaining from US\$0.2850 at end March to US\$0.2850 at 20th September 2021. Against the Australian dollar, the Kina has appreciated by 4.9 per cent from AU\$0.3752 at the end March 2021 to AU\$0.3937 at 20th September 2021.

Against the Australian dollar, the Kina has appreciated due to cross currency movement as Australian dollar weakened against the US dollar. The Australian dollar has depreciated over recent months and is below its levels at the start of the year. The depreciation occurred at the same time as the US dollar appreciated against a range of currencies including Australian dollar following the June Federal Open Market Committee (FOMC) meeting and as yields on the Australian Government bonds declined relative to those of the major advanced economies.

Against the US dollar, the Kina remained unchanged between March 2021 and September 2021 reflecting BPNG's intervention in the foreign exchange market.

Chart 1: Daily Exchange Rate Movements



Source: Bank of PNG

III. MEDIUM TERM FRAMEWORK AND PROJECTIONS – The Budget Repair and Reconstruction Plan

The medium-term projections in this strategy paper set out the budget repair and reconstruction plan for the government. As set out by the Marape Government back in the 2020 budget the plan is based on the following principles:

- spend the money we have more wisely,
- raise the revenues more fairly,
- finance the debt more cheaply,
- leverage friendly international support more intelligently,
- focus on growth in the agriculture, forestry and fishing sector, SMEs and the informal economy,
- distribute resource benefits more equitably,
- stimulate non-resource growth back to at least 5.0 per cent annually,
- comprehensive Government SOE reform program for cheaper energy, internet and water,
- getting foreign exchange flowing more freely, and
- create at least 10,000 jobs annually.

Passing of the 2021 Budget took into account significant adjustment to the macro-fiscal indicators of the Government's medium term fiscal framework, due to the macroeconomic shock to the GDP as a result of the COVID-19 pandemic in 2020.

The 2021 MYEFO reported an increase in the expenditure of K679.5 million, which was offset by the increase in revenue of K679.5 million. As a result, the macro-fiscal indicators of the 2021 Budget has been maintained. Supporting the increase in revenue is the nominal GDP which has now been revised slightly upwards driven by anticipated recovery of the domestic economy and pickup in commodity prices. Hence, the medium term fiscal indicators were revised to reflect these developments.

The 2022 Budget and associated medium term framework was framed with a debt-to-GDP ceiling range of 45.0 per cent to 60.0 per cent with a trajectory to bring down the debt-to-GDP ratio to 40.0 per cent in ten (10) years in line with the amended *FRA*. In addition to the core fiscal anchors, in 2021 the Government has also introduced and embarked on an expenditure rule which clearly stipulates that the Operating Budget is to decline as percent of non-resource GDP. This is to ensure more emphasis is placed on the Capital Budget to increase investment and grow the economy. Implementation of the 2021 Budget takes into account the amendment to the *Central Banking Act (CBA)*, which allowed the Government to secure a higher Temporary Advance Facility (TAF), of up to K1.5 billion for cash flow management purposes. This allows the Government better capability to execute the national budget plan in the face of within-year cash flow constraints that have been affecting Government finances in recent years.

Table 3: Summary Medium Term Framework 2022-2027

	2020 FBO	2021 Budget	2021 MYEFO	2022 BSP	2023	2024	2025	2026	2027
Revenue and Grants	12,093.3	12,995.0	13,674.5	15,730.2	17,269.1	19,073.1	21,016.1	23,412.0	25,956.4
Expenditure	19,397.8	19,607.8	20,287.3	21,825.2	22,156.8	23,004.8	24,159.2	25,683.0	27,245.8
Operational Budget	10,331.2	9,866.2	10,298.8	11,349.2	11,279.2	11,565.5	12,198.2	13,110.6	14,006.2
Capital Budget	6,901.5	7,470.8	7,887.7	8,151.6	8,446.2	8,903.3	9,373.1	9,905.5	10,507.0
Interest payments	2,165.1	2,270.8	2,100.8	2,324.4	2,431.3	2,535.9	2,587.9	2,666.9	2,732.5
Deficit	-7,304.5	-6,612.8	-6,612.8	-6,095.0	-4,887.7	-3,931.7	-3,143.1	-2,271.0	-1,289.4
Debt to GDP ratio	49.2%	51.5%	50.3%	52.4%	52.7%	52.9%	52.2%	50.5%	47.7%

Source: Department of Treasury

The medium-term fiscal projections have now been revised with an added outlook up to 2027. Under the revised framework, revenue envelope for 2022 is projected to be K15,730.2 million with a target revenue of K25,956.4 million by 2027. This is mainly driven by the continued growth in the economy and improvements in the tax administration and compliance. The dividend flows from the PNG LNG project are expected to commence from 2026, although the expected increase in MPT from the project are now looking like they could be delayed until 2029 due to ongoing additional allowances under the agreement. A new banking and telecommunications tax is also expected to lift revenues.

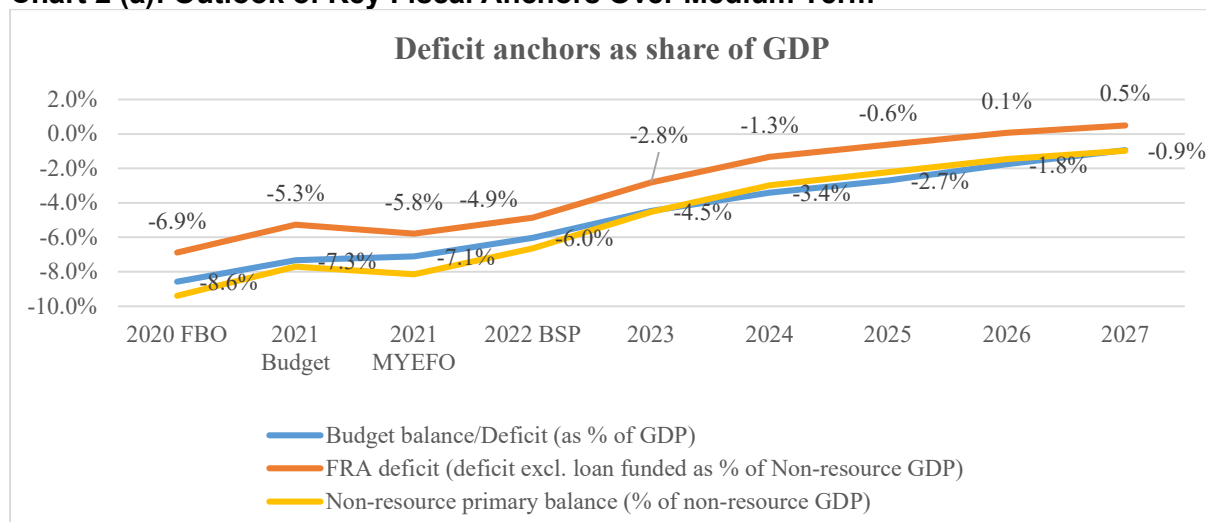
The expenditure envelope for 2022 has been revised upwards in the medium-term framework to K21,825.2 million with estimated expenditure of K27,297.2 million by 2027.

The Budget deficit for 2022 will be K6,095.0 million or 6.0 per cent of GDP, representing major budget repair from the 8.9 per cent of GDP in the 2020 FBO. This is a very rapid rate of fiscal consolidation by international standards, although not quite as rapid as the expectations at the time of the 2021 budget. The major change since then has been the inclusion of K600 million in estimated GoPNG election costs, which adds 0.6 per cent of GDP to the deficit figure. Taking a medium-term perspective, the deficit is expected to reduce to K1,340.9 million or 0.9 per cent of GDP by 2027. This reflects the gains of a steady hand of on-going budget repair, sensibly balancing the important task of protecting the budget to protect the economy. The long-term dividends are shown by the start of the rapid reduction in the debt to GDP ratio as shown in the following table. Overall, the medium-term framework is framed based on the need to control debt sustainability, increased investment spending to support economic activity and growth, and fiscal consolidation over the medium term, noting the uncertainty posed by the COVID-19 pandemic.

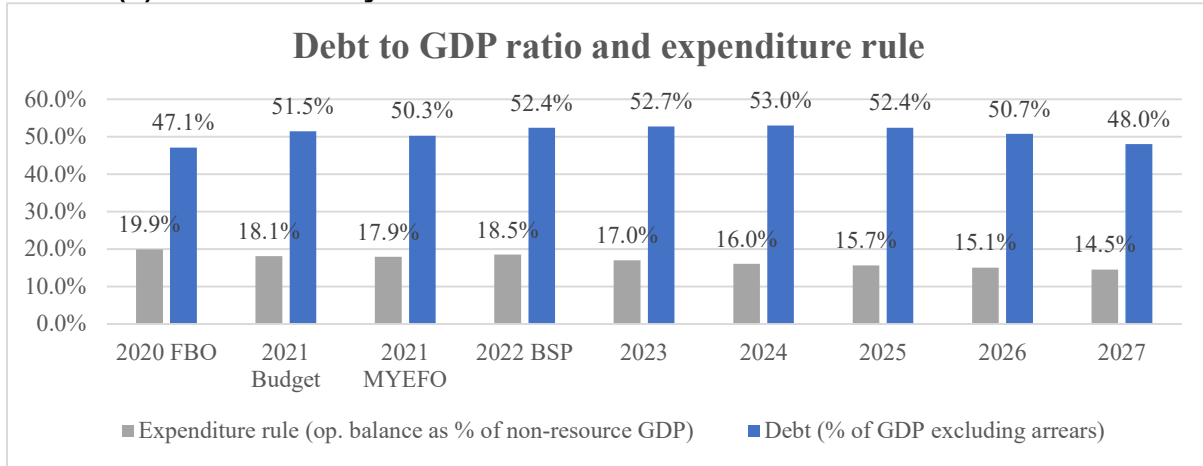
The MTFS up to 2027 targets a debt to GDP ratio of 47.7 per cent, which is well within the Government's debt target of 60.0 per cent of GDP and is on track to be reduced to under 40.0 per cent in ten (10) years (by 2030) as per the *FRA (2020)* amendment.

The benefits of the government's budget repair and reconstruction plan are set out in the below chart showing the careful restoration of a balanced budget, while ensuring capital is funde.

Chart 2 (a): Outlook of Key Fiscal Anchors Over Medium Term



Source: Department of Treasury

Chart 2 (b): Outlook of Key Fiscal Anchors Over Medium Term

Source: Department of Treasury

a. Revenue

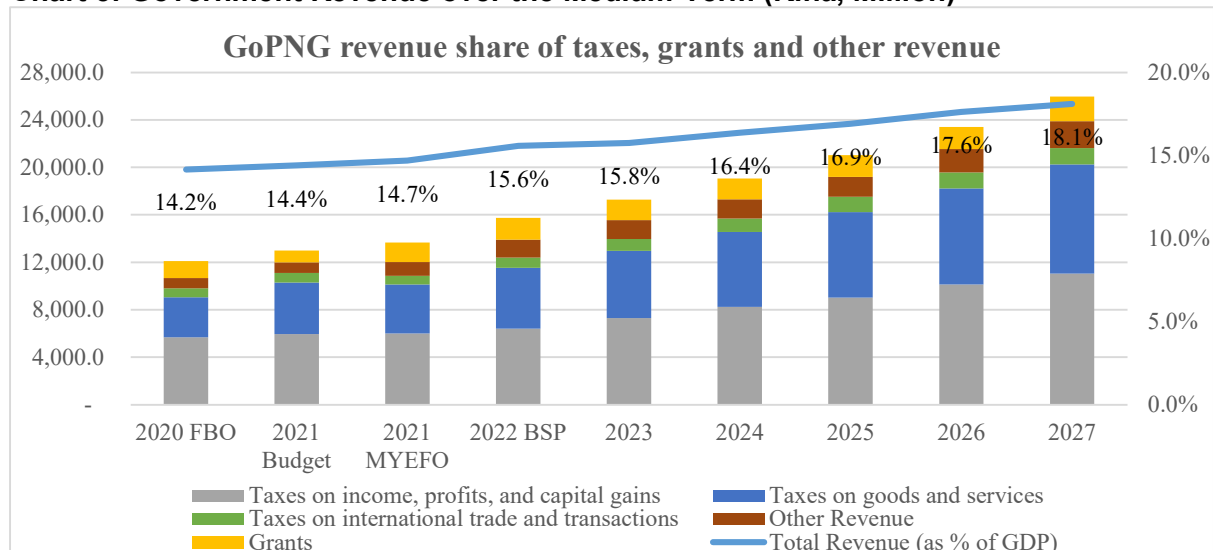
Tax revenue is expected to grow as economic activities pickup over the medium term rebounding from the negative shock from the COVID-19 pandemic, with some potential upside as the Medium Term Revenue Strategy (MTRS) reforms are progressed by the Internal Revenue Commission (IRC) and PNG Customs Service (PNGCS). Similarly, Other Revenues will hinge upon reforms to dividend payments and fees and charges, and the *Non-Tax Revenue Administration (NTRA) Bill* in drawing revenues from collecting agencies.

Table 4: 2022 BSP and Medium Term Revenue Profile (Kina, Million)

	2020 FBO	2021 Budget	2021 MYEFO	2022 BSP	2023	2024	2025	2026	2027
Total Revenues and Grants	12,093.3	12,995.0	13,674.5	15,730.2	17,269.1	19,073.1	21,016.1	23,412.0	25,956.4
Total Revenue (as % of GDP)	14.2%	14.4%	14.7%	15.6%	15.8%	16.4%	16.9%	17.6%	18.1%
Taxes	9,802.1	11,109.7	10,868.3	12,401.0	13,952.6	15,684.1	17,529.9	19,576.7	21,615.2
Taxes on income, profits, and capital gains	5,668.6	5,945.3	6,010.8	6,413.5	7,312.9	8,244.9	9,013.5	10,122.5	11,052.1
Taxes on payroll and workforce	0.4	-	0.5	-	-	-	-	-	-
Taxes on goods and services	3,372.7	4,351.1	4,127.1	5,117.1	5,643.5	6,304.2	7,209.8	8,111.0	9,184.6
Taxes on international trade and transactions	760.4	813.2	730.0	870.4	996.2	1,135.0	1,306.6	1,343.2	1,378.5
Grants	1,425.0	1,008.3	1,643.0	1,824.9	1,724.9	1,774.9	1,824.9	1,874.9	2,074.9
Other Revenue	866.2	877.0	1,163.2	1,504.3	1,591.5	1,614.0	1,661.3	1,960.4	2,266.3

Source: Department of Treasury

The full scope of compliance returns from the MTRS are not yet included in the projections and therefore, represent an upside risk to revenue.

Chart 3: Government Revenue over the Medium-Term (Kina, Million)

While the revenue estimate is 15.6 per cent of GDP for 2022, there are still rooms for improvement as expenditure needs increases. The Government will support revenue improvement measures initiatives for the revenue raising agencies to ensure revenue grows beyond the current target in the MTRS.

Some of the key initiatives of the revenue raising agencies being considered, subject to further validation, are: the Goods and Service Tax Monitoring System (GMS) similar to Fiji that will be procured in 2022 and implemented in 2023; the procurement and installation of Container Examination Facility in Lae (one of PNG's biggest sea ports) in 2022, the modernisation of IRC's tax administrative system through the procurement and installation of a new Integrated Tax Administration System (ITAS) in 2022. These main proposals including other projects currently being worked on such as the passing of the rewritten Income Tax bill, the *Tax Administration Act* and the roll out of the GST section 65A to the extractive and Financing sector is also expected to support revenue generation in 2022 and over the medium term. The Treasury team is working with the relevant revenue raising agencies to provide the possible benefits of those projects closer to the Budget. This will improve the current outlook.

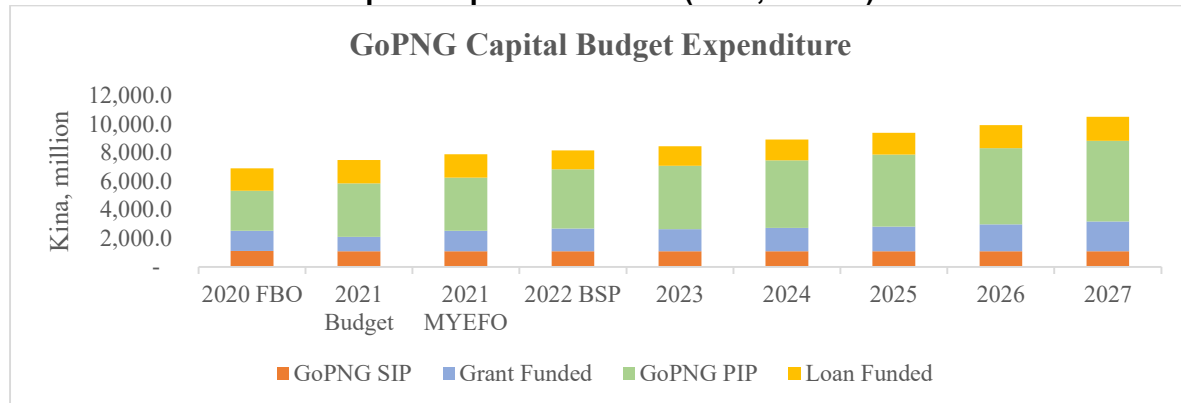
b. Expenditure

Total Expenditure is driven in part over the next few years by the repayment of arrears accrued in recent past years, with the profile expected to be revised depending on the identification of additional arrears, and the validation process the Government will undertake to ensure that arrears are legitimate.

The capital budget is anticipated to grow significantly with increased GOPNG PIP programs. Strong growth is also expected from donor grant based assistance. Development partners have approved approximately K7.0 billion in loan funded projects already, which gives the Government scope to continue funding such concessional project lending through provision of GoPNG PIP counterpart funding. One of the benchmarks of the Marape Government has been the increase in this good, cheap, project based financing. It has grown from an average level of K650m under the previous government to an average of K1,500 million over the last three years. Based on international advice on debt sustainability, and as some of this financing does not meet all criteria for concessionality (so the grant element does not exceed 35 per cent), the projected forward planning for this project loan funding will be adjusted back to K1,318 million in 2022 -still more than double previous levels. It would then grow in a steady

path from then, although at much lower levels than originally planned under the economic reform program.

Chart 4: Medium Term Capital Expenditure Path (Kina, Million)



Source: Department of Treasury

As highlighted above, the growth in capital expenditure over the medium term is driven the Government's objective to increase investment in PIP programs to stimulate economic activity and growth, especially in the rural areas to support recovery following the impact of the COVID-19 pandemic. Also, the increase reflects the need to commit counterpart funding for loan-funded programs to allow the Government to drawdown on the loan funds which the Government has already signed up to.

Table 5: Breakdown of Expenditure – 2022 BSP and Medium Term(Kina, Million)

	2020 FBO	2021 Budget	2021 MYEFO	2022 BSP	2023	2024	2025	2026	2027
Expenditure (MTFS Classification)	19,397.8	19,607.8	20,287.3	21,825.2	22,173.9	23,041.8	24,379.5	25,739.1	27,297.2
Operating Budget	10,331.2	9,866.2	10,298.8	11,349.2	11,296.3	11,602.6	12,418.5	13,166.7	14,057.7
Personnel Emoluments	5,831.5	5,763.8	6,030.4	6,050.2	6,174.0	6,077.4	6,292.1	6,569.8	6,861.7
Other Operating	4,499.7	4,102.4	4,268.4	5,299.0	5,122.3	5,525.2	6,126.3	6,596.9	7,195.9
Capital Budget/PIP	6,901.5	7,470.8	7,887.7	8,151.6	8,446.2	8,903.3	9,373.1	9,905.5	10,507.0
GoPNG PIP	2,807.9	3,724.4	3,724.4	4,158.3	4,437.0	4,724.9	5,022.0	5,328.1	5,649.5
GoPNG SIP	1,101.0	1,100.0	1,100.0	1,100.0	1,100.0	1,100.0	1,100.0	1,100.0	1,100.0
Grant Funded	1,424.9	1,008.0	1,424.9	1,574.9	1,524.9	1,624.9	1,724.9	1,874.9	2,074.9
Loan Funded	1,567.8	1,638.4	1,638.4	1,318.4	1,384.3	1,453.5	1,526.2	1,602.5	1,682.6
Debt Service	2,165.1	2,270.8	2,100.8	2,324.4	2,431.3	2,535.9	2,587.9	2,666.9	2,732.5

Source: Department of Treasury

The retirement program for public servants over the age of 65 has commenced in 2020, but is delayed due to the COVID-19 pandemic. While some progress has been made in retiring some public servants in 2021, the Government anticipates that it will not be able to fully expend the planned retirement arrears this year. Hence, part of it will be carried forward to 2022, and possibly 2023 depending on how the program is executed in the later part of 2021 and in 2022. As mentioned, the Government expects significant savings from the retirement program for CoE over the medium term, estimated at around K250 million per annum from 2025.

c. Financing

The revised MTdS as presented in the 2021 Budget will be maintained in the 2022 Budget and over the medium term. Although economic activities, particularly in the non-resource sector, have begun to pick up, the COVID-19 pandemic continues to impact the Government's revenue streams and its efforts to stimulate the economy. Hence, the 2021 planned borrowing composition of the Government's debt portfolio are maintained.

Following are the updates on the major strategies, which were planned to support the debt management objectives:

- Maintaining debt at sustainable levels.
The Government has adhered to the *FRA (amended)* target band of the 45.0-60.0 per cent debt to GDP. As at June 2021, the debt-to-GDP was 47.7 per cent and it's expected to be 50.3 per cent by the end of 2021. In 2022, it is projected to increase to 52.4 per cent, peaking in 2024 and then beginning a steady decline from reducing deficits and underlying GDP growth
- Maintaining financial risk at prudent levels:
 - The share of foreign currency debt (FXD) to total public debt is limited to 50.0 per cent. As at June 2021, FXD-to-Debt was 43.3 per cent and is anticipated to increase to 48.2 per cent. In 2022 it is projected that the share of FXD to public debt will be 47.7 per cent and is anticipated to remain below the 50.0 per cent over the medium term.
 - In 2022 the projected weighted average interest rate (WAIR) for domestic debt is 8.6 per cent and 2.8 per cent for external debt. The overall WAIR is 6.1 per cent.
 - Total interest cost as a share of the Government revenue (excluding grants) in 2022 is projected to be 16.7 per cent and expected be around 13.5 per cent on average over the medium term.
- Developing and efficiently managing the domestic debt market. This involves broadening and deepening the market in domestic securities and improving the market infrastructure;
- Developing and managing the offshore commercial market. This will diversify funding sources to provide an alternative market-based financing instrument. This eases domestic liquidity and foreign exchange constraints and provides PNG a sovereign reference price. This allows international investors to take a position in PNG, which also facilitates non-resident purchases of domestic bonds through a market-based assessment of interest differentials.

IV. 2022 BUDGET STRATEGY

This section sets out the key strategies underpinning the budget:

a. Fiscal Strategy

The 2022 Budget Strategy is being framed within the revised medium-term fiscal strategy (MTFS) and outlook that sets out the key 2022 elements of the government's ongoing plan of budget repair and reconstruction from 2022 to 2027. It is aimed at continuing support towards economic recovery from COVID-19 pandemic, continued focus on strengthening the revenue base, improving the quality of expenditure and obtaining cheap responsible financing within prudent risk levels, lowering loan interest costs and moving to reductions in the debt to GDP ratio, ensuring macroeconomic stability over the medium term.

The 2022 fiscal parameters are:

- BUDGET DEFICIT at -6.0% OF GDP (2022) vs -7.3% (2021 Budget), and -8.6% in 2020;
- FRA DEFICIT (ex. Concessional loans) at -4.9% of non-resource GDP (2022) vs -5.3% (2021 Budget);
- NON-RESOURCE PRIMARY BALANCE at -6.6% of non-resource GDP (2022) vs -7.7% (2021 Budget); and
- DEBT target at 52.4% of GDP (2022) vs 51.5% (2021 Budget), and moving to a ratio of under 50% by 2027

Consistent with the 2021 Budget, this framework will continue to embark to strike an appropriate balance between the challenge of stimulating the economy and meeting the requirement of fiscal sustainability and discipline. The following table summarizes the main indicators of 2022 BSP.

Table 6: 2022 Budget Strategy Fiscal Indicators (Kina, million)

	2020 FBO	2021 Budget	2021 MYEFO	2022 BSP
GDP	81,627.0	90,265.5	93,078.7	101,003.4
GDP Nominal Growth (%)	1.8%	10.6%	14.0%	8.5%
GDP Real Growth	-3.5%	3.5%	1.7%	4.8%
Total Revenue	12,093.3	12,995.0	13,674.5	15,730.2
Tax Revenue	9,802.1	11,109.7	10,868.3	12,401.0
Other Revenue (Non-Tax)	866.2	877.0	1,163.2	1,504.3
Grants	1,425.0	1,008.3	1,643.0	1,824.9
Total Expenditure	19,397.8	19,607.8	20,287.3	21,825.2
Operational Expenditure	10,331.2	9,865.9	10,298.8	11,349.2
Compensation of Employees	5,831.5	5,763.8	6,030.4	6,050.2
Goods and Services	3,324.5	2,788.9	3,058.4	3,946.4
CoE and G&S % of Total Expenditure*	49.2%	43.6%	44.8%	45.8%
Provincial Functional Grants	588.1	584.0	584.0	630.7
GST & BTT Transfers	587.1	729.2	626.0	721.9
Interest Payment (Debt Service)	2,165.1	2,270.8	2,100.8	2,324.4
Capital Expenditure	6,901.5	7,471.1	7,887.7	8,151.6
GoPNG PIP	3,908.9	4,824.4	4,824.4	5,258.3
as share of Total Expenditure	20.2%	24.6%	23.8%	24.1%
Concessional Loans	1,567.8	1,638.4	1,638.4	1,318.4
Donor Support Grants	1,424.9	1,008.3	1,424.9	1,574.9
BUDGET BALANCE	-7,304.4	-6,612.8	-6,612.8	-6,095.0
% of GDP	-8.6%	-7.3%	-7.1%	-6.0%
TOTAL FINANCING	7,304.4	6,612.8	6,612.8	6,095.0
Net External Borrowing	3,619.5	4,612.8	4,612.8	4,095.0
Net Domestic Borrowing	2,882.0	2,000.0	2,000.0	2,000.0
Net Use of Trust Fund Balances	802.9	0.0	0.0	0.0
TOTAL GOVERNMENT DEBT	40,168.4	46,464.4	46,781.2	52,876.2
Debt as % of GDP	49.2%	51.5%	50.3%	52.4%

Source: Department of Treasury. Note: The increase in the share of COE and G&S in 2022 is driven by the one-off Election expenditure which will come off in 2023 and going forward.

b. Revenue Strategy and Forecasts

The effects of the COVID-19 pandemic in 2020 and 2021 is expected to continue to impact revenue in 2022¹. The loss in business and income will manifest in reduced corporate income tax earnings next year as filings for 2021 assessable year become payable in 2022. Despite the moderate improvement in the domestic economic activities, a sizeable reduction in corporate income taxes is therefore, expected from earlier estimates. However, there is estimated to be a recovery in international trade and GST with the economic recovery.

The forecasts include a costing for a new telecommunications and banking levy that target the estimated super normal profits from the excessive industry concentration in these two sectors. The levies will be designed to fall primarily on these firms shareholders rather than the consumer.

In 2022, revenue envelope is expected to be around K15,730.2 million. This amount includes K456.2 million from the implementation of the *NTRA* bill expected to be fully implemented in 2022, fees and charges, and State-Owned Enterprises (SOE) reform measures (revised dividend policy) which is expected to be rectified and implemented in 2022. These revenue measures require policy actions to realise the amount costed. The Department of Finance (DoF) is working towards bringing the *Non-Tax Revenue Administration (NTRA) Bill* through Parliament for endorsement, while SOE reforms including the revised dividend policy, are expected to be implemented in 2022, building on from the progress made in 2020 and 2021.

Further, donor grants projections for 2022 has been revised slightly up from the 2020 outcome, taking into account the current trend in donor-funded spending and expected continued assistance from donor partners relating to the COVID-19.

¹ The revenue projection for 2022 BSP is based on the 2021 MYEFO report and the August revenue outturn report. Consultative meetings with IRC & Customs in the coming week as part of the Third Round Forecast will determine revenue estimate for 2022 Budget. Unless further substantive revenue measures are approved beyond the telecommunications and banking levy, this revenue is not expected to deviate significantly.

Table 7: 2022 Revenue (Kina, million)

	2020 FBO	2021 Budget	2021 MYEFO	2022 BSP
Total Revenue	12,093.3	12,995.0	13,674.5	15,730.2
<i>Tax Revenue</i>	<i>9,802.1</i>	<i>11,109.7</i>	<i>10,868.3</i>	<i>12,401.0</i>
<i>Taxes on payroll and workforce</i>	<i>0.4</i>	<i>0.0</i>	<i>0.5</i>	<i>0.0</i>
<i>Taxes on goods and services</i>	<i>3,372.7</i>	<i>4,351.1</i>	<i>4,127.1</i>	<i>5,117.1</i>
<i>Taxes on international trade and transactions</i>	<i>760.4</i>	<i>813.2</i>	<i>730.0</i>	<i>870.4</i>
<i>Other Revenue (Non-Tax)</i>	<i>866.2</i>	<i>877.0</i>	<i>1,163.2</i>	<i>1,504.3</i>
<i>Grants</i>	<i>1,425.0</i>	<i>1,008.3</i>	<i>1,643.0</i>	<i>1,824.9</i>
Resource Revenue	751.9	813.6	1,120.6	1,138.4
<i>Mining and Petroleum Taxes</i>	<i>183.4</i>	<i>313.6</i>	<i>520.6</i>	<i>538.4</i>
<i>Mining and Petroleum and Gas Dividends</i>	<i>568.5</i>	<i>500.0</i>	<i>600.0</i>	<i>600.0</i>

Source: Department of Treasury

The expected pick-up in international trade taxes and GST will depend critically on a pick-up in domestic business and retail conditions and on a resumption of inward investment flows. The assumptions are that recovery in trade taxes and GST are likely to be staggered over the next twelve (12) months. The domestic economic outlook described above is on the recovery path, which will see some recovery in these taxes in 2022. Recovery in the non-resource sector is projected to contribute to revenue growth in 2022, especially in GST. Substantial risks to fiscal outlook are a deterioration in global economy and further the COVID-19 infection periods.

The MTRS compliance measures have not been costed in the revenue forecasts. The Government will ensure provision of adequate resources to drive the MTRS reforms, including ensuring the effective operations of the MTRS Steering Committee. The administrative reforms currently under discussions are expected to significantly improve revenue in 2022 and over the medium-term. These measures will be properly costed and included in the Third Round Forecast carried out by Treasury to be included in the Budget proper.

c. Expenditure Rules and Guidelines

The 2022 Budget expenditure is expected to be around K21,825.2 million. This expenditure envelope will continue to support the policy key reforms introduced by this Government in 2020 and 2021 supporting the key reforms consistent with the principles of the 'Marape Manifesto' and the '*Loloata Commitment*', focusing on Connecting PNG, supporting rural communities, supporting SMEs, providing responsible government tuition fees (GTF); and strengthening SOE through smarter and targeted reforms.

Table 8: 2022 Expenditure (Kina, million)

	2020 FBO	2021 Budget	2021 MYEFO	2022 BSP
Total Expenditure	19,397.8	19,607.8	20,287.3	21,825.2
Operational Expenditure	10,331.2	9,865.9	10,298.8	11,349.2
Compensation of Employees	5,831.5	5,763.8	6,030.4	6,050.2
Goods and Services	3,324.5	2,788.9	3,058.4	3,946.4
<i>CoE and G&S % of Total Expenditure*</i>	<i>47.2%</i>	<i>43.6%</i>	<i>44.8%</i>	<i>45.8%</i>
Provincial Functional Grants	588.1	584.0	584.0	630.7
GST & BTT Transfers	587.1	729.2	626.0	721.9
Interest Payment (Debt Service)	2,165.1	2,270.8	2,100.8	2,324.4
Capital Expenditure	6,901.5	7,471.1	7,887.7	8,151.6
GoPNG PIP	3,908.9	4,824.4	4,824.4	5,258.3
<i>GoPNG PIP as share of Total Expenditure</i>	<i>20.2%</i>		<i>23.8%</i>	<i>24.1%</i>
Concessional Loans	1,567.8	1,638.4	1,638.4	1,318.4
Donor Support Grants	1,424.9	1,008.3	1,424.9	1,574.9

Source: Department of Treasury. Notes: * The increase in COE and G&S expenditure as a share of Total Expenditure in 2022 will reduce after the one-off Election related cost comes off in 2023.

The 2022 Budget expenditure envelope takes into account the 2022 National General Election cost of about K600 million in GoPNG funding and an estimates K150 million in international support.

The 2022 Budget framework proposes to carry forward the implementation of some of the key 2021 capital projects to ensure continuation in delivery of programs, especially those that are considered essential and are able to stimulate economic activities in the rural communities.

The Capital Budget in 2022 is expected to increase to K8151.6 million which is K263.9 million higher than MYEFO estimate and K605.8 million higher than the 2021 Budget estimate. This is mainly driven by significant increase in GoPNG capital by K433 million and donor grants.

The 2022 Budget donor support grants figure has been revised up from the 2021 MYEFO estimates to reflect the trend over the recent past years, including the 2020 FBO, and likely ongoing support for COVID-19 assistance.

The operational expenditure ceiling is largely maintained at the 2021 Budget levels for 2022, with the aim to protect and sufficiently support essential and priority social sectors areas such as education, health and law and order. Few adjustments were made: especially increased funding for GTFS; medical drugs; election cost of K600.0 million, as well as shifting part of the Retirement Program² that was delayed in 2020 and 2021 over to 2022. PE estimate is adjusted taking into account the 2021 MYEFO estimates and is expected to increase slightly to K6,050.2 million in 2022, which is mainly driven by estimated increases the number of teachers and the State-Share Contributions (8.4 per cent) for Superannuation. Interest cost is also revised upwards from the 2021 MYEFO to K2,324.4 million reflecting the ending of the Paris Club deferrals.

The increase in the expenditure and deficit is mainly driven by election costs, GoPNG PIP, GTFS, medical drugs, interest cost and the slight increase in constitutionally guaranteed grants for provinces. These increases are needed to ensure election is sufficiently funded and significantly important programs affecting PNG's populace are protected as well as ensuring that investment are increased to stimulate growth. The Government's recurrent budget is controlled to make space for the 2022 National General Election, at the same time increasing

² DPM has commenced implementation of the retirement program with first batch of retirees being paid out in pay 17 totaling approximately K3.0m. Hence, based on information currently available, it is estimated that about K200.0m will be expended for the retirement payments by end 2021, with K230.0m expected to be carried over into 2022 for continued implementation.

its capital investment budget to stimulate economic activity and growth. This is consistent with the Government's expenditure rule to reduce the combined PE and Goods & Services recurrent budget, as a share of non-resource GDP, until the long-term debt target of 40.0 per cent of GDP is reached, while increasing public investment as a share of non-resource GDP.

The Government is committed to continue to settle arrears to reduce the arrears debt stock while stimulating the economy in 2022. Since 2020, all arrears are being addressed through a process of verification and identification by the Arrears Verification Committee (AVC) who meets regularly and make recommendations to the Treasurer on payment of these arrears. The stock of Government arrears to be paid down in 2022 may be revised upon subsequent identification and verification.

Vigilance and prudent fiscal management remains necessary in 2022 to navigate against the potential risk elements, such as decline in commodity prices, second wave of the COVID-19 outbreak and the 'Delta Variant' outbreak, and a further fiscal deterioration in the 2021 final outturn. Failure to bring in the revenue as estimated in the 2021 MYEFO, as well as failure to gain meeting expenditure targets or delays in accessing the planned budget support loan from external financing will add pressure on the Government in ensuring its planned fiscal targets are met.

d. Debt Strategy and Risk

The Government will finance the 2022 deficit of K6,095.0 million through a mix of domestic and external financing. Discussions on possible sources of external financing for 2022 are still ongoing: For concessional project loans, disbursements for 2022 is projected to be around K1,318.4 million.

Working on the assumption that external financing (under discussion) come through, this will caters for about 66 per cent of the deficit. The remaining 34. per cent will be sourced domestically by issuing T-Bills and T-Bonds.

Table 9: 2022 Net Incurrence of Liabilities and Debt Stock

	2020 FBO	2021 Budget	2021 MYEFO	2022 BSP
TOTAL FINANCING	7,304.4	6,612.8	6,612.8	6,095.0
Net External Borrowing	3,619.5	4,612.8	4,612.8	4,095.0
Debt Securities	0.0	0.0	0.0	0.0
Concessional Financing	0.0	0.0	0.0	0.0
Commercial Financing	0.0	0.0	0.0	0.0
Extra-ordinary Financing	0.0	0.0	0.0	0.0
Loans	3,619.5	4,612.8	4,612.8	4,095.0
Concessional (Project) Financing	1,154.9	1,103.6	1,103.6	987.2
Commercial Financing	-876.3	-938.8	-938.8	-17.7
Extra-ordinary Financing	3,340.8	4,448.0	4,448.0	3,125.6
Net Domestic Borrowing	2,882.0	2,000.0	2,000.0	2,000.0
Debt Securities	2,976.7	2,100.5	2,100.5	3,328.4
Treasury Bills	1,710.5	500.0	500.0	500.5
Treasury Bonds	1,266.2	1,600.5	1,600.5	1,600.0
Loan	-94.7	-100.5	-100.5	-100.5
Net Use of Trust Fund Balances	802.9	0.0	0.0	0.0
TOTAL GOVERNMENT DEBT	40,168.4	46,464.4	46,781.2	52,876.2
Debt as % of GDP	49.2	51.5%	50.3%	52.4%
Net External Debt	17,952.8	23,207.8	22,565.6	26,660.6
Net Domestic Borrowing	22,215.6	23,256.5	24,215.6	26,215.6

Source: Department of Treasury

Other initiatives that may improve debt include:

- Expansion of the long term domestic borrowing, and a move towards utilising the domestic market to a greater extent. This will be supported by efforts to expand the accessibility of the local securities market to overseas investors;
- Continue the drawdown of undisbursed balance of concessional project loans as a boost for capital investment;
- The debt to GDP ratio is forecast to rise again in 2021 and 2022 because of continuing global economic conditions due to the COVID-19 pandemic, before turning around and declining from 2025 onwards;
- Increase revenue by sufficiently supporting the revenue raising agencies to increase the revenue in 2022 and over the medium term;
- These changes will necessitate a set of additional reporting, including tables of valuation changes, other flows and arrears movements in order to ensure full transparency and accuracy.

The frequency at which variable interest rates change must be taken into account when projecting debt-servicing costs for better cash flow management. The Average Time to Refixing (ATR) is a measure of weighted average time until all principal payments in the debt portfolio become subject to a new interest rate.

The current FX variable loans need to be reset every 6 months to account for changes in underlying rates such as LIBOR while the FX fixed rate loans require resetting after 9.7 years. In the domestic portfolio, ATR for T-Bonds is 5.6 years and about 7 months for T-bills. In total 48.7 per cent of the entire debt portfolio is subject to interest rate movements in one year. That is, within one year, interest costs pertaining to 48.7 per cent of the debt portfolio subject to interest rate movements can increase debt service expenditure above the appropriation.

Table 10: Risk Associated with Debt

Summary Table Risk Indicators 2021		Foreign Currency Debt	Domestic Currency Debt	Total debt
Amount (in millions of PGK)		25,152.3	28,922.0	54,074.3
Cost of debt	Weighted Average Interest Rate (%)	2.8	8.6	6.1
Interest rate risk	ATR (years)	6.5	2.8	4.5
	Debt refixing in 1yr (% of total)	37.0	58.9	48.7
	Fixed rate debt including T-bills (% of total)	64.9	97.0	82.1
	T-bills (% of total)	0.0	52.4	28.1

Source: Department of Treasury.

The weighted average interest rate for external loans is 2.8 per cent while domestic weighted average interest is 8.6 per cent. On average, domestic rates are much higher than current global market rates. If the Government continues on the path of depending heavily on international financing, the cost of borrowing will continue to decrease. This reinforces the work on budget repair and reducing deficits.

Taking into account the above framework, the Government (through Department of Treasury) is working on the 2022 Borrowing Plan that will promote and encourage the lowest possible cost over the medium, consistent with a prudent degree of risk.