



INDEPENDENT STATE OF PAPUA NEW GUINEA

2023 Budget Strategy Paper

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I. PURPOSE

In the 2022 National Budget the Government outlined its 13-year plan for budget repair and reconstruction. The aim of this plan was to reach a surplus by 2027 and, if desired, present an option to pay off the whole debt stock by 2034. The 13-year plan was intended to ensure PNG remains on a sustainable debt path and to support use of funds to reduce the deficit as well as invest in new infrastructure and expanding public services in health, education and crucially law and order. Importantly, the plan is based on the conservative but internationally accepted practice of not including any new resource projects until they have reached the Final Investment Decision. On the likelihood that major new resource projects will commence, there will be upsides on the 13 year plan.

The 2023 Budget strategy will continue to be guided by this 13-year plan, and the path it envisages for expanding public services. It also will be guided by the Five (5) National Goals and Directive Principles, the National Strategy of Responsible Sustainable Development (StaRS), and PNG's commitment to the 17 United Nations Sustainable Development Goals (SDGs) that are captured in the development principles defined by Vision 2050, and Development Strategic Plan 2030, and woven into the prescriptions of Medium Term Development Plans (MTDPs) II and III. In 2020, the Government 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. This strategy has been revised further as outlined in the Government's 13-year fiscal plan as presented in the 2022 Budget.

This year, 2022, marks the end of the current Medium Term Fiscal Strategy (MTFS) 2018--2022. The 2023 BSP and subsequent 2023 Budget will be guided by the new MTFS 2023--2027, which is embedded in the 13-year plan, but the key principles of *'spend the money we have more wisely'*, *'raise the revenues more fairly'* and *'finance the debt more cheaply'* will remain. The strategy will continue on the path of fiscal consolidation as envisaged by the Marape-Rosso Government..

The broad objectives of the budget repair programme under the 2023 Budget strategy, consistent with the 2022 Budget, is to provide the platform for fiscal consolidation whilst at the same time continuing to support economic growth and community services through: strategic human and capital formation, . expanding the tax base; and improving the delivery of essential services.

The 2023 Budget will continue to be built around these 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. ECONOMIC OUTLOOK

Since the original establishment of the 13-year plan economic conditions around the world, and as a result in PNG, have changed. As the world adjusts to a new normal with COVID-19, the opening up of countries has led to an expansion in growth, but at the same time the after effects of COVID have meant substantial disruption to shipping, labour markets and financial markets. The emergence of higher international inflation, and the Ukraine-Russian war, are now pushing down global growth prospects.

a. World Economic Outlook

The global economy has been hit hard in 2022 with a more severe slowdown than previously anticipated. Global inflation has been climbing to highs never seen in decades, monetary policy tightening across regions has intensified, Russia's invasion of Ukraine and the re-emergence of COVID-19 have further amplified the uncertainty surrounding the growth prospects of the global economy.

The global growth forecast as per the 2022 October World Economic Outlook (WEO) update expects growth to slow from 6.0 per cent in 2021 to 3.2 per cent in 2022. In 2023, disinflationary monetary policy is expected to bite, with global output growing by just 2.7 per cent, 0.2 percentage point lower than the July WEO forecast. This is the weakest growth profile since 2001 excluding the global financial crisis and the recent global pandemic and reflects significant slowdowns in the major economies.

For advanced economies, drastic downturns especially in the United States in the first half of 2022, a Euro area contraction in the second half of 2022 and further COVID-19 restrictions and lockdowns in China coupled a property crisis have dragged growth down from 5.2 per cent in 2021 to 2.4 per cent in 2022 and 1.1 per cent in 2023. With the slowdown gaining momentum, the growth forecast has been revised down by 0.1 percentage points for 2022 and 0.3 percentage point for 2023 against the July WEO, respectively. For the United States, growth was revised down from 5.7 per cent in 2021 to 1.6 per cent in 2022 and 1.0 per cent in 2023. Growth in 2022 has been revised down by 0.7 percentage points, due to tighter monetary policy further intensifying interest rate hikes thus reducing household consumption and aggregate demand. For the Euro area, growth is projected at 3.1 per cent in 2022 and 0.5 per cent in 2023, which is 0.5 percentage points higher than the July forecast for 2022 and a downward revision for 2023. The moderate growth for 2022 is driven mainly by recovery in tourism-related services and industrial production in the first half of 2022 in Spain and Italy, while Germany and France have both experienced negative annual growth. Growth for 2023 remains weak, which reflects the spill over effects from the Russia-Ukraine war – especially for countries vulnerable to the severe energy crisis in that region.

For emerging markets and developing economies (EMDEs), the severe slowdown in China's economy has reduced growth expectations by 0.2 percentage points to 4.4 per cent in 2022 and 0.1 percentage points to 4.9 per cent in 2023 respectively. China's growth was revised down by 0.1 percentage points to 3.2 per cent in 2022 as further lockdowns and an expanding real estate crisis, combined with major global spill overs, have pushed growth down for the world's second largest economy and exporter. This excludes the impact of the initial COVID-19 crisis in 2020 but reflects the recent outbreak and lockdowns. Similarly, India's growth fell by 0.6 percentage points to 6.8 per cent, mainly reflecting a weaker outturn in the second quarter and more subdued external demand. In 2023, India is expected to grow at 6.1 per cent. In other EMDE regions, growth is expected to decline to 3.7 per cent in 2022 and remain constant in 2023. This mainly reflects a smaller-than-expected contraction in the European EMDEs.

Global inflation is expected to continue its surge with an increased projection of 8.8 per cent in 2022 from 4.4 per cent in 2021 – an upward revision of 0.5 percentage points since July

and decline to 6.5 per cent in 2023, and 4.1 per cent in 2024. Advanced economies are also expecting an enormous upswing in their inflation growth by 7.2 per cent in 2022 from 3.1 per cent in 2021. This is an upward revision of 0.6 percentage points and 1.1 percentage points in 2022 and 2023 respectively, compared with the July forecast. The rise is propelled by substantial pickups in the headline inflation of major global economies, such as the United States (0.4 percentage points rise to 8.1 per cent), and the Euro area (1.0 percentage point rise to 8.3 per cent). The 2024 forecast remains unchanged in general. For the EMDE region, inflation is expected to reach 9.9 per cent in 2022 before moderating to 8.1 per cent in 2023. There is greater variations in the revision to the EDME inflation forecast across regions, with a modest rise in Asia but larger revisions for Latin America, the Caribbean and developing Europe.

The risks to the outlook are substantial and mostly to the downside. The drive to monetary policy tightening could overshoot the path to reduce inflation as policy paths in the major economies could greatly differentiate - leading to excessive dollar appreciation and cause further trade tension across borders. A resurgence of COVID-19 or fresh global health scares could further cloud growth prospects. The economic slowdown in China could also dampen global demand and thus further affect cross-border trade and consumption. Also, geopolitical fragmentation could obstruct global trade and cooperation.

b. 2022-23 Domestic Economic Outlook

In 2023, the PNG economy is expected grow by 4.5 per cent in real terms. Growth in the non-resource sector is expected to increase in real terms by 4.8 per cent in 2023. This is attributed to growth in the AFF sector supported by the strong growth in the BLS sector as the resumption of Porgera and early works of Papua LNG are anticipated to have spill-over benefits to the BLS sectors. In addition, the K1.4 billion PNG Ports maritime port infrastructure development and Connect PNG are expected to provide stimulus to growth in the construction sector.

The non-resource sectors performance in 2023 will be underpinned by the underlying factors highlighted above and are as follows:

- The Transport and Storage sector is expected to grow by 4.0 per cent. The resumption of the Porgera mine will support growth as the mine operations are anticipated to increase activity for trucking and logistic companies and the overall movement of goods to the mining site;
- The Real Estate sector is expected to grow by 2.0 per cent supported by Porgera mine resumption and improved labour mobility as COVID-19 restrictions eased fully
- The construction sector is estimated to grow by 3.0 per cent driven by the PNG ports maritime port infrastructure development projects and Connect PNG

Growth in the Mining & Quarrying sector is projected to rebound and grow strongly by 17.3 per cent in 2023. The strong rebound in growth for the sector reflects the resumption of the Porgera mine expected in the second quarter of 2023 since the shut-down in April 2020. In addition, production from the Ok Tedi mine is expected to increase as a result of better access to high grade ores (impact of the new Crusher).

The Oil and Gas sector is projected to contract by -2.8 per cent in 2023. This is due to a substantial downgrade in condensate and LNG production and is mainly associated with the production systems. Despite the contraction in the Oil and Gas sector, the projected strong growth in the Mining and Quarrying sector is expected to offset the contraction in the Oil and Gas sector.

The AFF sector is projected to grow at 2.9 per cent in 2023. This growth is driven by increased coffee and log production.

Over the medium term, real growth is projected to grow on average by 3.8 per cent annually as Porgera return to normal production going forward. For non-resource sector, growth is expected to be supported by increased production in the AFF, Connect PNG program and spill-over effects of Porgera full year operation. Note also that the medium term growth projection does not capture any major pipeline projects.

Presented below are the assumptions on economic parameters for the medium term. The major economic parameters (see table 1) such as GDP are projected to grow in real terms supported by the growth in the non-mining sector.

Headline inflation is projected to increase by 6.2 per cent in 2022 reflecting the impact of Russian-Ukraine war on oil prices, and to decline to 5.6 per cent in 2023, as oil prices fall and supply constraints improve globally.

On the commodity front, oil prices (WTI) are projected to increase strongly from US\$68 per barrel in 2021 to US\$103 per barrel in 2022 reflecting the impact of the Russia-Ukraine war. The OPEC + producers have stuck to their July 2021 decision to steadily wind back (the COVID-induced) production cuts of early 2020 putting downward pressure on prices. Increased supply from the US is expected to help offset Russian production losses. With sluggish demand, prices are forecast to soften over the forecast period averaging US\$89 a barrel in 2023 and US\$81 in 2024.

Prices of PNG's precious metals, in particular gold, are expected to increase slightly in 2022, reflecting resistance to sharp increases in real bond yields so far this year, and then decline in 2023. However, prices are expected to rise strongly in the outer years driven by safe haven demand amid high global economic uncertainty and geopolitical tensions. For base metals, the copper price is expected to fall in 2022, as COVID-19 containment measures and high energy prices weigh on demand and decrease further in 2023 as mine production grows.

Table 1: Economic Parameters (2020-2027)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act.	Est.	Est.	Est.	Proj	Proj	Proj	Proj	Proj
Economic Growth									
Total Real GDP (%)	4.5	-3.5	0.3	4.7	4.4	3.3	3.4	3.5	3.8
Non-mining Real GDP (%)	1.6	-1.2	5.2	4.4	4.8	4.5	4.7	4.8	5.1
Inflation									
Average on Average (%)	3.6	4.9	4.5	6.2	5.6	5.4	5.1	5.0	4.9
Dec on Dec (%)	2.7	5.1	5.7	6.4	5.1	5.0	5.2	5.0	4.1
Exchange rate									
Real Exchange Rate Index (2007 = 100)	138.7	140.6	138.4	137.7	141.6	141.6	141.6	141.6	141.6
Interest rate									
Kina Rate Facility (KFR)	5.50	3.00	3.00	3.25	3.25	3.25	3.25	3.25	3.25
Inscribed Stock (3 year yield)*	10.5	9.0	9.0	6.0	6.0	6.0	6.0	6.0	6.0
Mineral Prices									
Gold (US\$/oz)	1392	1770	1800	1783	1820	1858	1896	1920	1939
Copper (US\$/ton)	6006	6170	9308	9475	9421	9273	9156	9041	8999
Oil (Kutubu Crude: US\$/barrel)	57.0	39.5	67.9	103.0	89.3	81.2	75.7	72.0	69.9
LNG (US\$ per thousand cubic feet)	10.6	8.3	10.8	16.6	14.0	13.1	12.2	11.6	11.2
Condensate (US\$/barrel)	57.0	39.5	67.9	103.0	89.3	81.2	75.7	72.0	69.9
Nickel (US\$/tonne)	10960	10639	17147	17647	13467	13887	13899	14402	14500
Cobalt (US\$/tonne)	22836	21483	44430	50745	37050	33942	30479	30335	30100
USD per PGK	0.2952	0.2890	0.2850	0.2841	0.2840	0.2840	0.2840	0.2840	0.2840
AUD per PGK	0.4247	0.4229	0.3795	0.4047	0.4140	0.4140	0.4140	0.4140	0.4140

* 2022 to 2027 rates are projected average

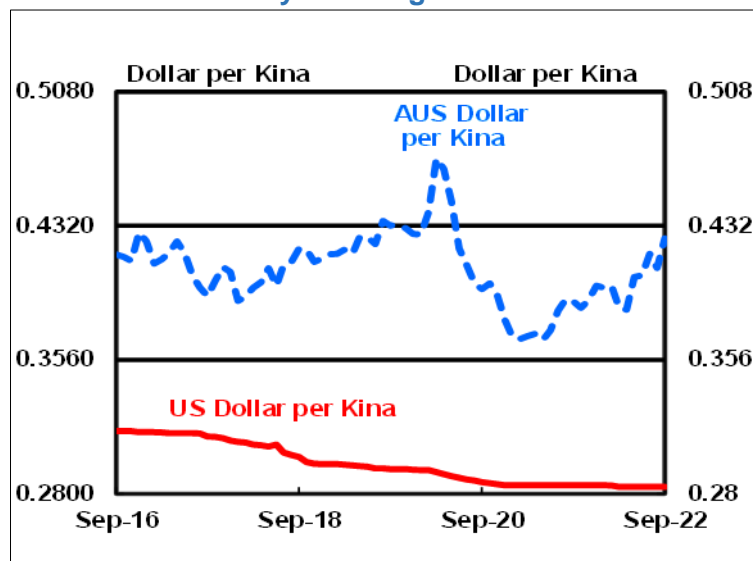
Source: Department of Treasury

Notes: GDP-actuals up to 2020 is from NSO, and estimates and projections from Treasury. All others actuals up to 2021.

Since the release of the Monetary Policy Statement (MPS) in March by the Bank of PNG (BPNG), the Kina has been unchanged against the USD, maintaining US\$0.2840 at end March 2022 to US\$0.2840 at end September 2022. This reflects the continued management of the exchange rate by the BPNG to support the Kina against the USD and to control inflation.

Against the AUD, the Kina has appreciated by 15.1 per cent from AU\$0.3796 at end March 2022 to AU\$0.4368 at end September 2022 due to the weakening of the AUD against the USD. The strong appreciation of US dollar amidst tightening of financial conditions in most regions of the world to curb inflationary pressures, has decreased demand for Australia's export commodities in China reflecting slowdown in Chinese economic activity have weakened the Australian dollar.

Chart 1: Daily Exchange Rate Movements



Source: Bank of PNG

c. 2022 Supplementary Budget

The 2022 Supplementary Budget was largely based on the MYEFO outcome. The Marape Government introduced the 2022 Supplementary Budget which provides Total Expenditure and Net Lending of K23,373.6 million, against a Total Revenue and Grants envelope of K17,389.1 million, resulting in a budget deficit of K5,984.7 million.

Table 2: 2022 Supplementary Budget (Kina, million)

Details	2022 Budget	2022 MYEFO	2022 Supp. Budget	Budget Variance
Total Revenue and Grants	16,190.2	17,066.0	17,389.0	1,198.8
Total Expenditure and Net Lending	22,174.8	23,050.6	23,373.6	1,198.8
Net Lending (+)/Net Borrowing (-)	-5,984.7	-5,984.7	-5,984.7	0.0
% of GDP	-5.9%	-5.4%	-5.4%	0.5%

Source: Department of Treasury

During the first half of the year, the outbreak of the Russia-Ukraine War posed a substantial challenge to the Government in terms of executing the budget. The increase in fuel prices as well as the rise in prices of general goods and services added a major burden to individuals, businesses and the community as a whole. The Marape Government introduced a Relief Package, initially valued at K611.0 million which rose to an estimated K728.3 million with the

extension of GST and excise relief on retail sales of fuel. This package is aimed at easing the cost-of-living pressures on families brought about by the war. The 2022 Supplementary Budget formalised these adjustments.

The 2022 Supplementary Budget approved an increased appropriation of K1,198.8 million for the 2022 Fiscal Year, comprising of K965.5 million in operational expenditure and K233.3 million in capital expenditure. Given the increase in global oil prices, and the adjustments made to accommodate the fiscal relief package, primarily having all Ok Tedi dividends for 2022 directed to the budget, revenue has also been revised upwards by the same amount (K1,198.8 million) to K17,389.0 million. This means that there was no change in the size of the original budget deficit.

An allowance of K295.5 million was also made available for likely overruns on CoE in the 2022 MYEFO, increasing the CoE appropriation to K6,345.7 million.

Further, the 2022 Supplementary Budget reappropriated and/or increased appropriations for certain key Government priorities including:

- K255.0 million for the Government Arrears program;
- K243.0 million for SIPs (including funding for the seven new districts and moving the SIP payments back to the K10.0 million of former years);
- K160.0 million for GTFS (project fees);
- K30.0 million for Sustainable Development Goal 8 (SDG) Program; and
- K15.0 million for Urban Infrastructures.

III. MEDIUM TERM FRAMEWORK AND PROJECTIONS

The medium-term projections and the subsequent 2023 Budget strategy will focus on the goal of budget repair and reconstruction. This will be framed in the context of the 13-year plan. The focus will be on growing revenues faster than expenditures, thereby closing the budget deficit. As set out by the Marape Government in previous budgets, 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.

As highlighted above, the 2022 Supplementary Budget reported an increase in expenditure of K1,198.8 million, offset by the increase in revenue of the same magnitude (K1,198.8 million). As a result, the macro-fiscal indicators of the 2022 Budget have been maintained. Supporting the increase in revenue is nominal GDP growth 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 2023 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 by 2030 in line with the amended *FRA*. Implementation of the 2022 Budget took 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. The operation of the TAF will continue into the 2023 Budget, allowing the Government 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 of Revised Medium Term Framework 2023-2027

	2021 Actual	2022 Supp. Budget	2023 BSP	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.
Revenue and Grants	13,860.4	17,389.1	17,686.0	19,556.0	21,847.0	24,606.0	27,768.0
Expenditure	20,130.8	23,373.6	22,470.0	23,354.0	24,555.0	26,049.0	27,720.0
Operational Budget	10,574.8	12,064.2	11,199.0	11,630.0	12,424.0	13,523.0	14,796.0
Capital Budget	7,301.3	8,985.1	8,840.0	9,188.0	9,543.0	9,959.0	10,433.0
Interest payments	2,254.7	2,324.4	2,431.0	2,536.0	2,588.0	2,567.0	2,491.0
Deficit	-6,270.3	-5,984.7	-4,784.0	-3,798.0	-2,708.0	-1,443.0	48.0
% of GDP	-6.8%	-5.4%	-4.2%	-3.1%	-2.1%	-1.0%	0.0%
Debt to GDP ratio	52.2%	50.3%	50.1%	50.4%	49.3%	47.2%	44.5%

Source: Department of Treasury

The medium-term fiscal projections have now been revised in line with the new Medium Term Fiscal Strategy (2023-2027) and the Government's 13-Year Fiscal Plan. Under the revised framework, the revenue envelope for 2023 is projected to be K17,686 million with a target revenue of K27,768 million by 2027. This is mainly driven by the continued growth in the

economy and improvements in the tax administration. Increased dividend flows from the PNG LNG project are expected to commence from 2026.

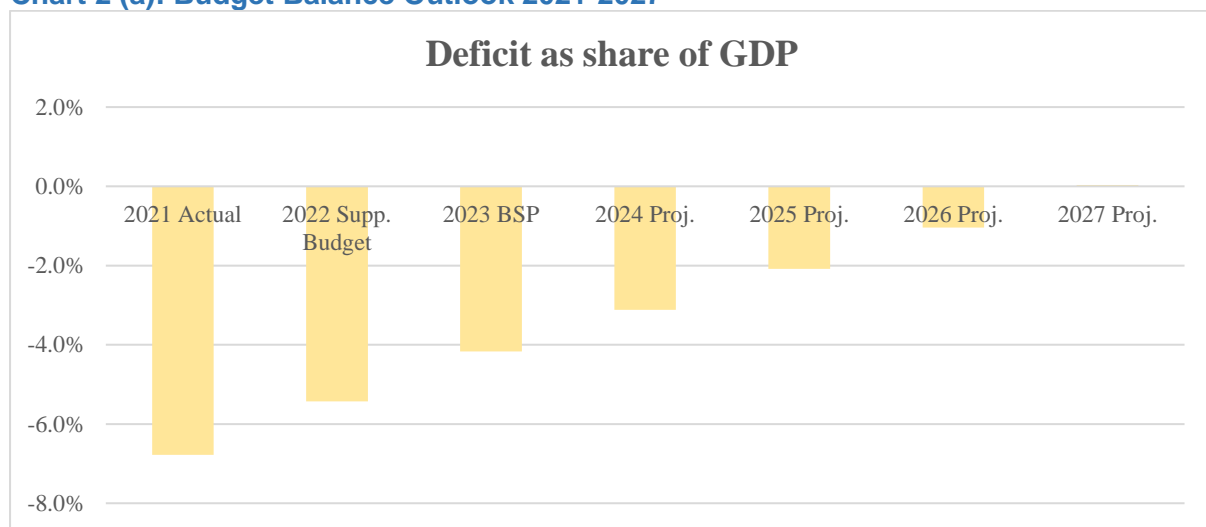
The expenditure envelope for 2023 is K22,470.0 million with estimated expenditure of K27,720 million by 2027.

The Budget deficit for 2023 is estimated at K4,784.0 million or 4.2 per cent of GDP, an improvement from the 6.8 per cent of GDP in the 2021 FBO. This is a very rapid rate of fiscal consolidation by international standards. Overall, the medium-term framework is based on the need to achieve debt sustainability, increase investment spending to support economic activity and growth, and fiscal consolidation and sustainability over the medium term.

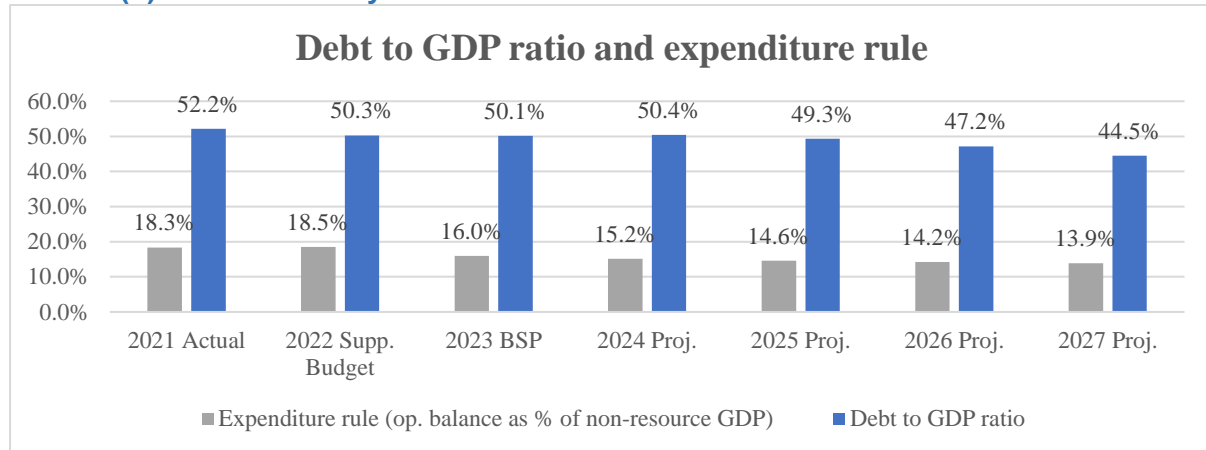
The MTFS (up to 2027) targets a debt to GDP ratio of under 45 per cent, which is within the Government's debt target of 60.0 per cent of GDP and consistent with the Government's plan to have the ratio reduced to under 40.0 per cent by 2030 as per the *FRA (amended 2020)*. The Government remains optimistic that economic reforms undertaken in the last three (3) years and over this MTFS period will further assist in easing the pressure on debt. Also, increased revenue inflow from the PNG LNG project are expected to flow through in 2026, which will further improve the debt and fiscal position going forward.

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

Chart 2 (a): Budget Balance Outlook 2021-2027



Source: Department of Treasury

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

Source: Department of Treasury

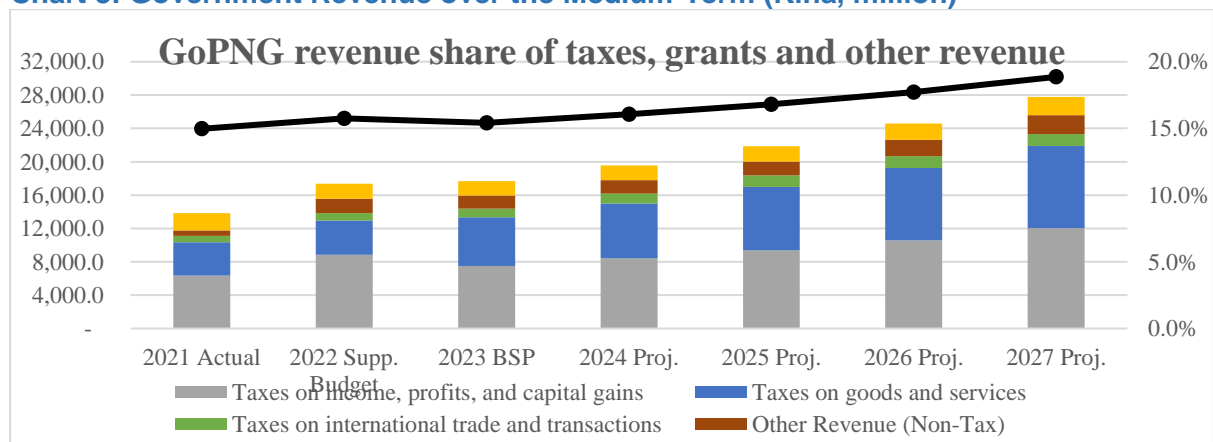
a. Revenue

Tax revenue is expected to grow as economic activity accelerated over the medium-term, rebounding from the negative shock of the COVID-19 pandemic, and the Russia-Ukraine War, with some potential upside as the new MTRS reforms are progressed by IRC and PNGCS. Similarly, Other Revenues will hinge upon reforms to dividend policy and fees and charges payments, and the NTRA Bill in drawing revenues from collecting agencies.

Table 4: 2023 BSP and Medium Term Revenue Profile (Kina, million)

	2021 Actual	2022 Supp. Budget	2023 BSP	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.
Total Revenues and Grants	13,860.4	17,389.1	17,685.7	19,555.5	21,847.2	24,606.0	27,768.0
Total Revenue (as % of GDP)	15.0%	15.8%	15.4%	16.1%	16.8%	17.7%	18.9%
Taxes	11,129.4	13,831.5	14,369.2	16,166.8	18,361.3	20,668.8	23,328.5
Taxes on income, profits, and capital gains	6,356.1	8,841.9	7,506.4	8,413.4	9,385.8	10,594.4	12,051.8
Taxes on goods and services	3,993.7	4,130.2	5,816.8	6,561.9	7,604.9	8,669.4	9,835.4
Taxes on international trade and transactions	778.8	859.4	1,046.0	1,191.4	1,370.6	1,404.9	1,441.4
Grants	2,088.0	1,824.9	1,724.9	1,774.9	1,824.9	1,975.0	2,175.0
Other Revenue (Non-Tax)	643.0	1,732.7	1,591.5	1,613.9	1,661.0	1,962.3	2,264.5
Total Revenue (excluding grants)	11,772.4	15,564.2	15,960.8	17,780.6	20,022.3	22,631.1	25,593.0

Source: Department of Treasury

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

Source: Department of Treasury

While the revenue estimate for 2022 is 16.1 per cent of GDP, there remains room for improvement as expenditure needs are also increasing. The Government will support revenue improvement initiatives for the revenue-raising agencies to ensure revenue grows beyond the target in the new MTRS.

Some of the key initiatives of the revenue raising agencies being considered are: the Goods and Services Tax Monitoring System (GMS), that is expected to be procured and trialled in 2023 and implemented in 2024; the modernisation of IRC's tax administrative system through the procurement and installation of a new Integrated Tax Administration System (ITAS), which is expected to be implemented in 2024; and the procurement and installation of the Container Examination Facility in Lae (one of PNG's biggest sea ports) in 2023. These key projects include others currently being worked on such as the roll out of the GST section 65A to the Extractive and Financing sectors and implementation of *Tax Administration Act 2017* in 2023 which are all expected to continue supporting the revenue generation in 2023 and over the medium term. The DoT is working with the relevant revenue raising agencies to estimate possible benefits of those projects closer to the 2023 Budget.

b. Expenditure

Expenditure changes in the 2023 budget will be based on the 13 year plan as well as take into account the major structural shift that has occurred in the structure of government expenditure since 2018. This is set out in the following table covering percentage changes in the major expenditure categories between 2018 and the 2022 Supplementary Budget.

Table 5: Structural Changes in Expenditure

	2018 FBO	2022 Supp. Budget	Percentage growth since 2018
TOTAL EXPENDITURE	16,134	23,374	45%
Operating	9,531	12,064	27%
Salaries	5,198	6,346	22%
Goods and Services (inc Provincial)	4,333	5,719	32%
Debt Service	1,935	2,324	20%
Capital	4,668	8,985	92%
GoPNG	2,041	6,092	198%
Project Loans	792	1,318	66%
Project Grants	1,836	1,575	-14%

Source: Department of Treasury

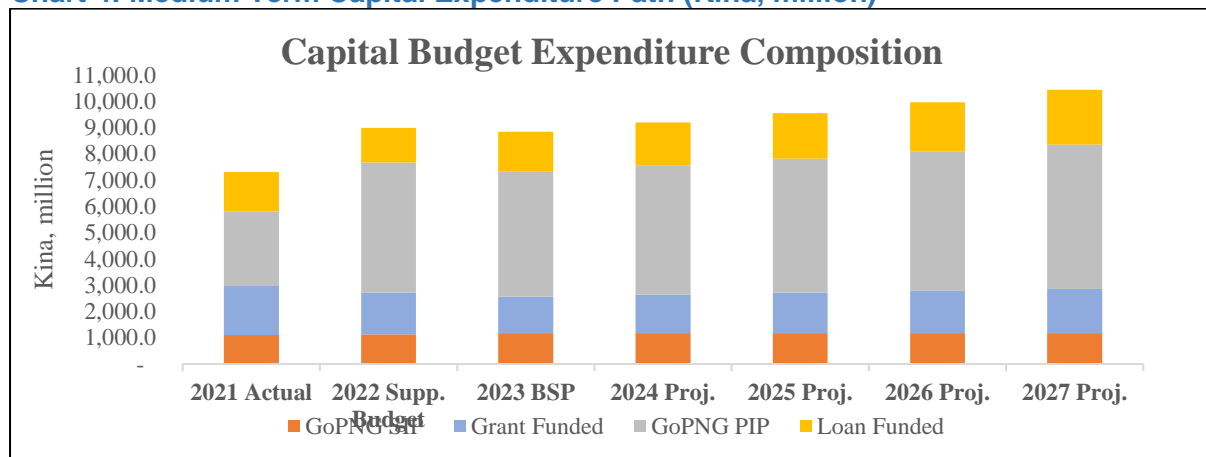
The key message of this table is that the capital budget has expanded in a major way under the current Government, with an overall increase of 92.0 per cent. More specifically, the part of the capital budget that is most directly controlled by the Government of PNG, the Public Investment Program, has grown by an extraordinary 198.0 per cent.

In contrast, the operating budget has increased by only 27.0 per cent. The salaries growth figure, despite wage over-runs during the year, has only increased by 22.0 per cent. This has barely kept up with inflation. Goods and services have increased more significantly, but the 2022 Supplementary Budget estimate includes K750.0 million to fund the 2022 election. In addition, the Goods and Services line includes payments to Provincial Governments which have been increasing in line with legal requirements on the distribution of function grants and GST transfers.

Within the Goods and Services line, there has also been the substantial 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 expansion in the capital budget in recent years has been vital to support growth in physical and infrastructure capital. Consideration will be given to providing greater support to investing in human capital. Strong growth is expected from donor grant base 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 good, cheap, project-based financing. It has grown from an average level of K650.0 million under the previous government to an average of K1,500.0 million over the last three (3) years. Based on international advice on debt sustainability, and as some of this borrowing does not meet the criteria for classification as concessional financing (as the grant element is below 35.0 per cent), the projected forward planning for this project loan funding will be adjusted.

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 by the Government's objective to increase investment in PIP programs to stimulate economic activity and growth, especially in the rural areas. Also, the increase reflects the commitment by the Government to increase counterpart funding for loan-funded programs to allow drawdown of approved loan funds on which the Government is currently paying interest.

Table 6: Breakdown of Expenditure – 2023 BSP and the Medium Term (Kina, million)

	2021 Actual	2022 Supp. Budget	2023 BSP	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.
Total Expenditure	20,130.7	23,373.6	22,778.0	22,929.6	24,075.5	25,434.8	25,961.6
Operating Budget	10,574.8	12,064.2	11,590.3	11,876.0	12,414.0	13,544.7	13,965.6
CoE	6,093.8	6,345.6	6,337.0	6,433.0	6,867.0	7,389.0	7,954.0
Other Operating	4,481.0	5,718.6	4,862.0	5,197.0	5,557.0	6,134.0	6,842.0
Capital Budget/PIP	7,301.3	8,985.1	8,526.3	8,631.6	9,504.1	9,853.2	10,414.8
GoPNG PIP	2,838.0	4,960.7	4,751.0	4,929.0	5,112.0	5,301.0	5,495.0
GoPNG SIP	1,107.5	1,131.0	1,180.0	1,180.0	1,180.0	1,180.0	1,180.0
Grant Funded	1,862.4	1,574.9	1,384.0	1,454.0	1,526.0	1,603.0	1,683.0
Loan Funded	1,493.5	1,318.4	1,525.0	1,625.0	1,725.0	1,875.0	2,075.0
Debt Service	2,254.7	2,324.4	2,431.0	2,536.0	2,588.0	2,567.0	2,491.0

Source: Department of Treasury

The retirement program for public servants over the age of 65 commenced in 2020, but was delayed due to the COVID-19 pandemic. While some progress has been made in retiring public servants in 2021 and 2022, not all public servants who were scheduled for retirement were retired as planned. Hence, part of the program will be carried forward and implemented

in 2023. To date, a total of 1,403 public servants were retired at a total cost of K164.3 million¹. The Government will continue to pursue the retirement program over the medium term, together with other reform programs, as part of its efforts to clean-up the payroll and control the increasing growth in CoE.

c. Financing

The total net financing requirements for 2023 is anticipated to be K4,785.0 million and will be financed through a similar strategy employed in the last two years. External financing will comprise budget support loans from our multilateral and bilateral creditors, drawdowns from concessional loans, and a new commercial loan for project implementation. The domestic financing will include Treasury Bonds and Treasury Bills issuances.

The Government will continue to utilise cheap and concessional sources of financing by engaging actively with our multilateral and bilateral partners. A number of new concessional project loans have already been signed and drawdowns will commence in 2023. The Australian Infrastructure Financing Facility for Pacific (AIFFP) will continue to roll out its infrastructure development loan projects over the medium term.

The Government will finance the 2023 deficit through a planned mix of domestic and external financing. The Government is in discussion with World Bank a new Development Policy Operation (DPO) for an expected USD100.0 million (K352.0 million), bilateral budget support finance is expected to be K1,418.8 million and financing through an IMF programme is expected to be SDR263.2 million (K1,213.5 million).

Table 7: 2023 Net Incurrence of Liabilities and Debt Stock

	2021 Actual	2022 Supp. Budget	2023
TOTAL FINANCING	6,270.30	5,984.70	4,785.0
Net External Borrowing	4,913.40	3,744.60	3,506.2
Monetary gold and special drawing rights (SDR's)	1,244.10	0	0.0
Debt Securities	0	0	0.0
Concessional Financing	0	0	0.0
Commercial Financing	0	0	0.0
Extra-ordinary Financing	0	0	0.0
Loans	3,669.30	3,744.60	3,506.2
Concessional (Project) Financing	1,108.30	708.1	515.8
Commercial Financing	-862.7	-19.7	-15.3
Extra-ordinary Financing	3,423.70	3,056.20	3,005.7
Net Domestic Borrowing	3,042.10	2,240.00	1,278.8
Debt Securities	2,995.40	2,010.10	1,283.8
Treasury Bills	1,394.80	260.1	338.8
Treasury Bonds	1,600.60	1,750.00	945.0
Loan	46.7	229.9	-5.0
Net Use of Trust Fund Balances	-1,685.20	0	0.0
TOTAL GOVERNMENT DEBT	48,173.20	52,765.00	57,550.0
% of GDP	52.2%	50.3%	50.1%

Source: Department of Treasury

The Medium-Term Debt Strategy (MTdS) will be revised in 2022 and cover the period 2023 to 2027. The goals of the current MTdS 2018-2022 include the following:

- 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 2022, the debt-to-GDP was 44.6 per cent and is expected to be 50.3 per cent by the end of 2022. Debt-to-GDP ratio is

¹ 2021: public servants retired was 825 at a cost of K108.3m. 2022: public servants retired was 578 at a cost of K56.0m.

projected to decline over the medium term resulting from reduced deficits and underlying GDP growth.

- Maintaining financial risk at prudent levels:
 - The share of foreign currency debt (FXD) to total public debt is targeted to be less than 50 per cent. As at June 2022, FXD-to-Debt was 49.9 per cent and is anticipated to decline slightly to 49.2 per cent. In 2023 it is projected that the share of FXD to public debt is projected at 50.8 per cent and is projected to increase over the medium term.
 - In 2023 the projected weighted average interest rate (WAIR) for domestic debt was estimated to be 8.6 per cent and 2.8 per cent for external debt. The overall WAIR was estimated to be 6.1 per cent.
 - Total interest cost as a share of the Government revenue (excluding grants) is projected to be 14.9 per cent by end 2022, and is projected to decline further to below 10.0 per cent by 2027.
- 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 with 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 rate differentials.

IV. 2023 BUDGET STRATEGY

This section sets out the key strategies underpinning the 2023 Budget:

a. Revenue Strategy and Forecasts

The economic effects of the COVID-19 pandemic in 2022 were less severe than expected, as people, businesses, and the Government learned to live and operate with COVID as part of the new normal – *'niupla pasin'*. Hence, the impact of the COVID-19 pandemic is also expected to be minimal in 2023. Despite the moderate improvement in domestic economic activities, a slight reduction in key tax heads such corporate income taxes (CIT), goods & services taxes (GST) and salary & wages taxes are therefore expected compared with earlier estimates. However, there is an estimated recovery in international trade and GST as international borders open up for trade.

In 2023, the revenue envelope is expected to be K17,686 million. This amount excludes the implementation of the NTRA Bill, fees and charges, and State-Owned Enterprises (SOE) reform measures (e.g., revised dividend policy). These revenue measures require policy actions to be realized. The Department of Finance (DoF) and DoT are working towards bringing the NTRA Bill through to Parliament again for endorsement, while SOE reforms including the revised dividend policy, are expected to be implemented in 2023, building on from the progress made in 2021 and 2022.

Table 8: 2023 Revenue (Kina, million)

	2021 Actual	2022 Supp. Budget	2023 BSP
TOTAL REVENUES AND GRANTS	13,860.4	17,389.1	17,685.7
Total Revenue (as % of GDP)	15.0%	15.8%	15.4%
Taxes	11,129.4	13,831.5	14,369.2
Taxes on income, profits, and capital gains	6,356.1	8,841.9	7,506.4
Taxes on goods and services	3,993.7	4,130.2	5,816.8
Taxes on international trade and transactions	778.8	859.4	1,046.0
Grants	2,088.0	1,824.9	1,724.9
Other Revenue (Non-Tax)	643.0	1,732.7	1,591.5
Of which: Resource Revenue	1,015.9	4,150.0	1,361.0
Mining and Petroleum Taxes	635.4	3,000.0	761.0
Mining, Petroleum and Gas Dividends	380.5	1,150.0	600.0

Source: Department of Treasury

The expected pick-up in international trade taxes and GST will depend critically on an improvement in domestic business and retail conditions and the 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 increases in these taxes in 2023. Recovery in the non-resource sector is projected to contribute to revenue growth in 2023, especially in GST. Substantial risks to the fiscal outlook include a deterioration in the global economy and further COVID-19 outbreaks. The ongoing Russia-Ukraine War will impact revenue in 2023 as well, providing an upside risk to resource revenue, if the war continues.

b. Expenditure Strategy and Forecasts

In line with the 13 year plan, the 2023 Budget expenditure is expected to be around K22,470 million. This expenditure envelope will continue to support the policy key reforms introduced by the Marape Government in 2021 and 2022 in supporting the key reforms consistent with the principles of the *'Marape Manifesto'* and the *'Loloata Commitment'*, in growing the economy, focusing on connecting PNG, supporting rural communities, supporting

SMEs, providing responsible Government Tuition Fees (GTF), and strengthening SOEs through smarter and targeted reforms.

Table 9: 2023 Expenditure (Kina, million)

	2021 Actual	2022 Supp. Budget	2023 BSP
Expenditure	20,131.2	23,374.1	22,470.2
% of GDP	21.8%	21.7%	19.9%
Operational Component	10,575.3	12,064.7	11,199.0
Compensation of Employees	6,093.8	6,345.6	6,337.0
Goods and Services	3,164.3	4,402.8	3,365.0
CoE & G&S as a % of Total Expenditure	46.0%	46.0%	43.2%
Provincial Functional Grants	589.0	593.9	681.0
GST & Book Makers Transfers	727.7	721.9	816.0
Interest Payment (Debt Service)	2,254.7	2,324.4	2,431.0
Capital Investment Component	7,301.3	8,985.1	8,840.2
GoPNG PIP	3,945.5	6,091.7	5,931.0
PIP as a share of Total Expenditure	19.6%	26.1%	26.4%
Donor Support Grants	1,862.4	1,574.9	1,525.2
Concessional Loans	1,493.5	1,318.4	1,384.0

Source: Department of Treasury.

The 2023 Budget framework proposes to carry forward the implementation of some of the key capital investment projects undertaken in 2021 and 2022 to ensure continuation in delivery of programs, especially those that are considered essential, are able to stimulate economic activities, and add value to the livelihood of the majority of the population who live in rural communities.

The Capital Budget in 2023 is estimated at K8,840 million which is a little lower than the 2022 Supplementary Budget estimate, but is far larger than the 2021 Outcome. This is mainly driven by significant increase in GoPNG PIP funding as well as donor grants and loan funded programs.

The operational expenditure projected at the time of the 2022 National Budget is slightly lower than the 2022 Supplementary Budget levels. The operational budget aims to protect and sufficiently support essential and priority social sectors areas such as education, health and law and order. A number of adjustments were made such as increased funding for GTFS, HELP, and medical drugs and shifting the remaining part of the Retirement Program over to 2023. The CoE estimate has been maintained from the initial projection at the time of the 2022 National Budget. A more updated estimate will be incorporated in the 2023 Budget proper.

The projected expenditure is mainly driven by CoE, GoPNG PIP, GTFS, medical drugs, interest cost and the slight increase in constitutionally guaranteed grants for provinces to account for the seven (7) new districts. These increases are needed to ensure critical programs affecting PNG's populace are protected as well as ensuring that investment is increased to stimulate 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 reducing the arrears stock while stimulating the economy in 2023. 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 Office of the Minister for Treasury on payment of these arrears. The stock of Government arrears to be paid down in 2023 may be revised upon subsequent identification and verification.

Vigilance and prudent fiscal management remains necessary in 2023 to navigate against the potential risk elements, such as decline in commodity prices, COVID-19 related disruptions to the global economy, and the final fiscal outcome for 2022. Failure to bring in the revenue as estimated in the 2022 Supplementary Budget, as well as failure to meet expenditure targets or delays in accessing the planned budget support loans from external financing will add pressure on the Government in ensuring its planned fiscal targets are met.

c. Debt Strategy and Risk

The Government will finance the 2023 deficit through a planned mix of domestic and external financing. Discussions on possible sources of external financing for 2023 are still ongoing.

Working on the assumption that external financing (under discussion) comes through, this will cater for about 50.9 per cent of the deficit. The remainder will be sourced domestically by issuing Treasury Bills and Bonds.

Table 10: 2023 Net Incurrence of Liabilities and Debt Stock

	2021 Actual	2022 Supp. Budget	2023 BSP
TOTAL FINANCING	6,270.3	5,984.7	4,785.0
Net External Borrowing	4,913.4	3,744.6	2,436.1
Monetary gold and special drawing rights (SDR's)	1,244.1	0.0	0.0
Debt Securities	0.0	0.0	0.0
Concessional Financing	0.0	0.0	0.0
Commercial Financing	0.0	0.0	0.0
Extra-ordinary Financing	0.0	0.0	0.0
Loans	3,669.3	3,744.6	2,436.1
Concessional (Project) Financing	1,108.3	708.1	861.8
Commercial Financing	-862.7	-19.7	-41.9
Extra-ordinary Financing	3,423.7	3,056.2	1,616.2
Net Domestic Borrowing	3,042.1	2,240.0	2,348.9
Debt Securities	2,995.4	2,010.1	2,319.0
Treasury Bills	1,394.8	260.1	819.0
Treasury Bonds	1,600.6	1,750.0	1,500.0
Loan	46.7	229.9	29.9
Net Use of Trust Fund Balances	-1,685.2	0.0	0.0
TOTAL GOVERNMENT DEBT	48,173.2	52,765.0	57,550.0
% of GDP	52.2%	50.3%	50.1%

Source: Department of Treasury

In line with the Government's plan since taking office, and the 13-year Fiscal Plan, the Government will continue to explore cheaper concessional financing options in order to reduce interest rate costs and financing risks. Furthermore, there are other initiatives that the Government will continue to explore in order to improve debt, including:

- expansion of long-term domestic borrowing, 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;
- increase revenue by sufficiently supporting the revenue raising agencies to increase the revenue in 2023 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 changes need be taken into account when projecting debt-servicing costs for better cash flow management. The Average Time to Re-

fixing (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 Treasury Bonds is 5.6 years and about 7 months for T-bills. In total, about 49.0 per cent of the entire debt portfolio is subject to interest rate movements in one year.

Table 11: Risk Associated with Debt 2022

Summary Risk Indicators		External Debt	Domestic Debt	Total Debt
Amount (in millions of PGK)		26,660.1	27,497.6	54,157.7
Amount (in millions of USD)		7,571.5	7,809.3	15,380.8
Nominal debt as percent of GDP		24.7	25.5	50.3
PV as percent of GDP		22.4	25.7	48.0
Cost of debt	Interest payment as percent of GDP ³	0.7	1.8	2.5
	Weighted Av. IR (percent)	2.8	7.2	5.0
Refinancing risk	ATM (years)	9.6	2.4	5.9
	Debt maturing in 1yr (percent of total)	3.7	53.8	29.1
	Debt maturing in 1yr (percent of GDP)	0.9	13.7	14.6
Interest rate risk	ATR (years)	5.7	2.4	4.1
	Debt refixing in 1yr (percent of total)	46.2	53.8	50.0
	Fixed rate debt incl T-bills (percent of total)	55.5	100.0	78.1
	T-bills (percent of total)	0.0	49.3	25.0
FX risk	FX debt (percent of total debt)			49.2
	ST FX debt (percent of reserves)			7.0

Source: Department of Treasury.

The weighted average interest rate for external loans is 2.8 per cent while domestic weighted average interest is 7.2 per cent. On average, domestic rates are higher than available global market rates. If the Government continues on the path of seeking cheaper international concessional 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 DoT) is working on the 2023 Borrowing Plan that will promote and encourage the lowest possible cost over the medium, consistent with a prudent degree of risk.