



INDEPENDENT STATE OF PAPUA NEW GUINEA

2007

SUPPLEMENTARY BUDGET SPEECH

DELIVERED BY

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Minister for Treasury and Finance

On the occasion of the presentation of the 2007 Supplementary Budget

Friday 5th October 2007



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Minister for Treasury and Finance

**Ministerial Statement
2007 Supplementary Budget
“Building National Prosperity”**

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Hon. Patrick Pruaitch, MP**

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1. INTRODUCTION

Mr. Speaker and Honourable Members of Parliament, it is a great honour for me to present to this House the 2007 Supplementary Budget.

Mr. Speaker, the greatest challenge for the newly elected Government is to improve service delivery to our people. In the medium term this challenge will become more pronounced, as the current commodity price boom ends and existing mines and oil fields either scale down or cease operations as they approach the end of their life span.

In light of this, the Government has adopted a strategic approach to move the country towards a better future. First, it will ensure the benefits of the current commodity price boom are spread across the country to benefit all our people. It will continue to use the additional revenue arising from the commodity price boom to fund one-off increases in Government expenditure that will provide infrastructure investment and debt reduction in order to strengthen the economy in the future.

Over the medium term, the Somare-Temu Government will also consolidate and improve the macroeconomic performance of the economy by: attracting new investments in the mineral and energy sectors; repaying public debt; strengthening the agriculture sector; making the economy more competitive and efficient; and creating an environment that is more conducive for businesses and investments.

Mr. Speaker, prudent fiscal management is always framed within the context of the prevailing economic environment. I therefore turn to discuss the state of the economy, before going on to outlining the main themes and initiatives of the 2007 Supplementary Budget.

2. STATE OF THE ECONOMY 2007

Mr. Speaker, the economy is in its fifth year of successive growth. The 2007 Mid Year Economic and Fiscal Outlook (MYEFO) Report revised expected economic growth in 2007 up to 5.2 per cent from 4.5 per cent forecast in the 2007 Budget. The good news is that there are signs of growth picking up across most sectors of the economy. Economic growth in 2007 is now expected to be even higher than the Mid Year Forecast and will be the highest since 1996, well outpacing population growth rate of 2.7 per cent.

This growth has real potential to increase income and raise the standard of living for many people. It also reflects increased business confidence, higher employment growth, stronger investment activities and higher business profits. The improved economic growth picture stems from a combination of political stability, prudent macroeconomic policies, low interest and inflation rates, as well as the higher international prices for the country's major commodity exports. A detailed rundown on all economic developments and the outlook will be provided with the release of the 2008 Budget which is scheduled for November 2007.

3. THE GOVERNMENT'S FISCAL POSITION

Mr. Speaker, the Government's fiscal and debt position has improved significantly. The budget has been in surplus over recent years and Government's total debt has declined from 72 per cent of GDP in 2002 to 39 per cent of GDP at the end of 2006 and is moving towards a sustainable level. The Government has also handled the surge in revenue associated with the commodity price boom well by maintaining recurrent expenditure at sustainable levels and using the windfall revenue to provide for the future by spending on one-off infrastructure investments and by repaying debt. The 2007 Supplementary Budget will continue to allocate funds in this manner.

Mr. Speaker, political stability and the Government's commitment to prudent fiscal policy and debt reduction has improved Papua New Guinea's international credit rating and standing. Recently, the international credit rating agency Standard and Poor's upgraded its long-term foreign currency rating on Papua New Guinea to B+. This suggests there is increasing confidence among foreign investors and domestic

businesses in Papua New Guinea. Mr. Speaker, it is tremendous to see some good news stories on Papua New Guinea conveyed internationally, and this Government plans to keep this positive momentum moving forward by continuing to adopt sound fiscal and economic policies.

The reduction of public debt has increased macroeconomic stability and investor confidence, and has helped to significantly reduce interest rates. The significantly reduced interest rates in turn have substantially reduced the Government's interest expense on loans – allowing more funds to be used for the Medium Term Development Strategy priorities.

3.1 Fiscal Developments in 2007

Mr. Speaker, I now turn to report on the Government's expected fiscal performance over 2007.

Revenue Estimates

Mr. Speaker, with high commodity prices and the solid growth in the non-mining & petroleum sectors, revenues collected by the Government in 2007 are substantially higher than anticipated in the 2007 Budget. The 2007 MYEFO outlined that with no Government decisions, a budget surplus of K1,207 million or 6.5% of GDP could be expected in 2007. Since the MYEFO was put together, Treasury has further revised the expected revenue estimates in 2007 upwards by K430 million.

This K430 million increase in expected revenue in 2007 since MYEFO is largely due to increased assessments of Mining and Petroleum Tax to be paid in 2007 rather than in 2008. Treasury now expects revenue to exceed the expenditure approved in the 2007 Budget by K1,637 million.

Allocating Additional Revenue

Mr. Speaker, in the Government's deliberations on allocating this extra revenue, we have taken into account the following factors:

- the uncertainty which remains in the revenue forecasts for the last quarter of 2007, particularly in relation to mining and petroleum tax – there could still be price falls or supply interruptions during the remainder of the year;
- the need to continue with prudent fiscal management and budget discipline;
- the large amounts already appropriated for spending in 2007 and all the funds that are available to be spent in trust funds;
- the harm which a larger increase than K200 million in domestic spending in the near future would cause through inflation, especially in the context of relatively loose monetary policy;
- responsibility for the future — most of the additional revenue to be allocated is derived from the sale of non-renewable natural resources of PNG, and so should be invested for future generations;
- ensuring that the entire population including those living in rural areas receives some ongoing benefit flowing from the proceeds associated with the commodity price boom; and
- the great development needs in PNG, combined with the need to improve service delivery right across the country, balanced against the desire to reduce Government debt to a more sustainable level, together with addressing other Government liabilities that are growing strongly.

Mr. Speaker, taking into account the factors that I have just mentioned, the Government has decided to use a balanced approach to allocating the funds available in the 2007 Supplementary Budget. The extra K1,637 million will be used to increase recurrent expenditure by K197 million and address both the pressing development needs of the country and to reduce the Government's public debt and other liabilities.

The 2007 Supplementary Budget is designed to improve the lives of our people by ensuring the extra revenues of the Government are spread throughout the country and benefit the vast majority of our people living in the rural areas. The 2007 Supplementary Budget also aims to further strengthen the Government's overall financial position.

Mr. Speaker, the 2007 Supplementary Budget has been formulated within the Government's medium-term framework, and is consistent with the *Medium Term Fiscal Strategy*, the *Medium Term Debt Strategy* and the *Medium Term Development Strategy 2005-2010*, which identifies the Government's spending priorities to promote economic growth and development.

4. 2007 SUPPLEMENTARY BUDGET

Mr. Speaker, the 2007 Supplementary Budget allocates K1,637 million in the following manner: K197 million for various recurrent expenditure; K 893 million for public infrastructure - with K240 million of this allocated for maintenance by sector, K356 million allocated by District under the District Service Improvement Program and K297 million for major improvements in infrastructure; K297 million for repaying Government debt and K250 million to reduce the Government's superannuation liabilities .

Mr. Speaker, I now turn to the detail of the sub allocations in the 2007 Supplementary Budget.

Firstly, **Recurrent Expenditure** of K197 million has been allocated on the following broad range of issues:

- National Agricultural Development Plan – K40 million.
- Civil Aviation Authority restructuring – K21 million.
- Provincial and local level disaster fund – K7 million.
- Maritime Boundary Project – K5 million.
- Technical Rapid Response Group – K3 million.
- Greenhouse Office – K1 million.
- Community Development – K0.61 million.
- Office of Rural Development – K0.75 million.

- Cocoa-pod and coffee borer counter measures – K12 million.
- Replenishing the Secretary's Advance for contingencies in the remaining part of the year — K20 million.
- Cost over-runs for the national election — K15 million.
- Increases in Special Support Grants (SSGs), associated with increases in expected mineral and petroleum revenue since Budget time — K15 million.
- Back-payment of Doctors salaries and wages – K10 million.
- Defence Force uniforms — K8 million.
- Outstanding legal fees — K8 million.
- Court orders — K8.54 million.
- NAQIA for measures against avian flu — K3 million.
- Marienberg Community College – K3 million.
- Murik Lakes Resettlement - K2.1 million.
- Carteret Islands Resettlement - K2 million.
- Mirigini Haus & Morauta Haus Refurbishment – K4 million.
- Financial Management Improvement Plan – K2 million.
- Land Development Committee – K 3 million.
- National Forest Authority Impact Project fast tracking – K3 million

Secondly, there will be K893 million in **Public Infrastructure** spending. This will be allocated to trust funds because spending on the projects involved will take some time.

There will be K240 million for public infrastructure maintenance

- Education infrastructure – K80 million.
- Health infrastructure – K80 million.
- Law & justice infrastructure – K80 million.

There will be K356 million to support the District Service Improvement Program.

- District Health Improvement Program – K89 million.
- District Water Supply Program – K89 million.
- District Law and Justice Program – K89 million.
- District Education Improvement Program – K89 million.

And there will be K297 million to fund major improvements in infrastructure

- Lae roads - K25 million.
- Wewak roads - K10 million
- Lae port – K145 million
- Wewak wharf – K37 million
- Central city – K30 million
- Port Moresby wharf re development– K10 million
- Institutional housing – K10 million
- Housing development – K15 million
- Urbanization Programme – K15 million

The third part of the Supplementary Budget is **K297 million to retire public debt.**

The fourth and final part is **K250 million to reduce the Government's liability for superannuation**, as the employer of public servants with Nambawan Super Limited (formerly POSF).

Mr. Speaker, these appropriations have been well thought out and are expected to have a beneficial impact on the lives of our people and country.

Pre-funding the maintenance of public infrastructure

Mr. Speaker, the appropriation of K893 million for the improvement and maintenance of public infrastructure is money that will be well spent over time as appropriate spending plans are developed and implemented. This Government acknowledges the need to increase funding for maintenance and development of roads and other public infrastructure. The maintenance of public infrastructure funds will have K240 million allocated by sector, K356 million allocated by District and K297 million for major improvements in infrastructure.

When the former Treasurer announced the allocation of windfall revenue to rehabilitation of essential public infrastructure in the 2007 Budget Speech, he said –

“It will also be imperative to ensure that sufficient priority is given to ongoing maintenance in the future to ensure that we do not repeat the mistakes of the past.”

K240 million of this year’s additional revenue will supplement agencies’ budget appropriations for the specific purpose of maintaining public infrastructure. The law and justice, health and education sectors will each receive K80 million. Since there is value in showing the Government’s commitment to spending on maintenance for years ahead, it is appropriate to pre-fund that spending by depositing funds in a trust account exclusively for this purpose. However, access to these funds will be closely monitored and financial guidelines put in place to ensure accountability and to prevent misuse or reallocation of these funds.

Pre-funding for infrastructure maintenance, by holding out a clear prospect of several years’ work, should encourage construction companies to invest in greater capacity. There are currently few construction companies available locally to work on road projects or rehabilitate other public infrastructure. It is reported that most of their construction equipment is leased from overseas. Companies should be more likely to see profit in leasing equipment, and in recruiting and training staff, if spending agencies increase the amount of major maintenance work done through multi-year contracts, rather than as one-off projects. Visible pre-funding of maintenance could encourage both public and private sector planning.

Mr. Speaker, the 2007 Supplementary Budget has allocated K356 million to support the District Service Improvement Program with funds for infrastructure maintenance. Each of the 89 Districts will receive K4 million each, to be spent on supplementing the District Service Improvement Programs for health, water supply, law and justice and education. This measure represents a concerted effort by the Government to ensure that the benefits of the commodity price boom are spread right throughout the country. These funds will also be placed into a trust, to be drawn down as appropriate spending plans are implemented over time.

The Government has also allocated K297 million for the major infrastructure improvements which were listed above.

District Service Improvement

Mr. Speaker, the K356 million funding to the Districts is the biggest support this Government has ever given. This is the Government's commitment to rural people of Papua New Guinea – who make up 87 per cent of the population – to improve service delivery at the Local Level and District Government levels.

The allocation in the past has been K400,000 per District, and this allocation of K4 million per District is saying that Districts must now consolidate in terms of improving service delivery facilities and becoming key service centres for Government programs and policy intervention in rural development. This is substantive sign to the people of PNG that the Somare-Temu Government is very serious about consolidating service delivery at the District level and empowering the lives of ordinary Papua New Guineans in the rural areas.

Mr. Speaker, I must apply caution here as well. This K4 million is such a large increase, from K400,000 previously, that there must be corresponding increase in accountability by all Districts. This is a call also to Open Members of Parliament who are Chairman of the Joint District Budget Planning Priorities Committee, to ensure that their District administrations are organised to deliver on projects and report on them as well, to meet Public Accountability Requirements.

Mr. Speaker as part of the "Accountability" measure, I have instructed the Secretary of Finance to ensure that the Finance Instruction governing public expenditure compliance for such funding is enforced accordingly. Mr. Speaker, there has been a lot of talk about District service delivery, however I must inform this house and the people of PNG that this increase to K4 million from K400,000 to the Districts is a true and substantive commitment to say that enough is enough, the Districts must now be consolidated to improve service delivery and really contribute to empowering ordinary Papua New Guineans.

Repaying Government Debt

Mr. Speaker, the Government's net debt as a percentage of GDP has fallen impressively over recent years, but it remains well above what is considered to be a

sustainable level. Additional debt repayment will further strengthen the Government's financial position as it reduces our vulnerability in the event of any downturn or any shock to the economy. Mr. Speaker, the appropriation of K297 million to retire public debt will benefit the country in four different ways:

First, it will immediately strengthen the Government's financial and fiscal position, particularly on the spending side of the Budget. Every year, resources will be freed from debt servicing and redirected to fund priority expenditures. Repaying K297 million of debt will free up about K15 million of interest savings in a full year. These funds can be used for service delivery, new investments, or maintenance of public infrastructure on an on-going basis.

Second, debt repayment reduces risk — if interest rates rise, or the currency depreciates, the impact on interest expenses will be smaller. This provides the greatest flexibility for future Budgets.

Third, debt repayment has a positive effect on the economy. It assists to lower interest rates, helping to reduce borrowing costs for all businesses and individuals within the country. This creates an environment conducive for private sector led economic growth.

Fourth, debt repayment reduces the country's stock of debt and improves the Government's balance sheet. An allocation of K297 million for debt repayment would bring the ratio of public debt to GDP down from 39 per cent at the end of 2006 to about 34 ½ per cent of GDP at the end of 2007. This generates two positive effects - it helps to improve the country's credit rating which builds international and domestic confidence, as in the recent Standard and Poor's upgrading of Papua New Guinea. It also reduces the debt obligations on our children, and their children, creating a brighter future for Papua New Guinea.

Reducing the State's Superannuation Liability

Mr. Speaker, the Government also has an estimated K1,600 million outstanding liability for superannuation contributions. These are unfunded superannuation obligations to public servants who are members of Nambawan Super Limited. Economic growth over recent years, and with it increases in the values of real property and commercial assets, has resulted in strong earnings from the investment of members' contributions, which the State is required to match when it pays its obligations. While the economy and investment returns remain healthy, the prospective liability for the State is likely to keep growing rapidly.

Mr. Speaker, for this reason, it is in the State's advantage to gradually reduce this liability. This will be done by a series of transfers of funds to Nambawan Super Limited, to hold and invest on members' behalf, starting with an initial amount of K250 million from the 2007 Supplementary Budget.

Such transfers to Nambawan Super Limited, as well as reducing the cost through time of the State's liability, will be invested mainly in developing private businesses and infrastructure in PNG. From the perspective of assisting to develop PNG's economy, this represents an excellent use of the Government's additional revenue.

CONCLUSION

Mr. Speaker, in conclusion, let me reiterate the key messages.

The economy is experiencing robust economic growth and the Government's fiscal position has significantly improved. The country's greatest challenge is to improve the lives of our people.

The Government will first ensure that the entire population including those living in rural areas receives some ongoing benefit flowing from the proceeds associated with the current commodity price boom. Over the medium term, the Somare-Temu Government will also consolidate and improve the macroeconomic performance of the economy by: attracting new investments in the mineral and energy sectors; repaying public debt; strengthening the agriculture sector; making the economy more efficient and competitive; and creating an environment conducive for businesses and investments.

The 2007 Supplement Budget is set within a medium term-framework. It is spending more money on Government priorities such as the maintenance of public infrastructure in education, law and justice, health, wharfs and roads. It delivers a substantial amount of funds to new infrastructure projects and to each and every District of the country so that the benefits of high commodity prices are spread across the country.

The 2007 Supplementary Budget sets the foundations for national prosperity using prudent fiscal management. We have shielded the recurrent budget from the effects of any possible downturn in international commodity prices. The Government will live within its budget; retire debt and other liabilities in order to improve the Government's financial position. We will continue to strengthen the private sector, improve the maintenance of public infrastructure, and will gradually improve service delivery to our people. This is aimed at enhancing confidence and capacity in the economy to promote long-term economic growth.

The 2007 Supplementary Budget represents a significant step forward on a long journey that will lead us to a better future for all Papua New Guineans. We have the finance available to undertake our own projects and fund our own priorities. We now need to see our Government departments and agencies follow through with appropriate spending plans and effective implementation.

Mr. Speaker, it is with great pleasure that I commend the Appropriation Bill for the 2007 Supplementary Budget to the House.