



THE INDEPENDENT STATE OF PAPUA NEW GUINEA

2015 BUDGET SPEECH

***“Building Our Nation and Providing
Opportunities for our People”***

DELIVERED BY

**HON. PATRICK PRUAITCH, CMG, MP
TREASURER**

On the Occasion of the Presentation of the 2015 National Budget to Parliament

Tuesday, 18th November 2014



**HON.PATRICK PRUITCH, CMG, MP
TREASURER**

Mr. Speaker,

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

Mr Speaker, Honourable Members, and fellow citizens of Papua New Guinea, it is a great honour for me to present to this Honourable House and the people of PNG the 2014 Supplementary Budget and the 2015 National Budget.

This is the third budget since the O'Neill-Dion Government took office in 2012 and my first as Treasurer in the present Government.

Honourable Members would be aware that this is the 14th consecutive year of economic growth enjoyed by PNG, the longest such period of sustained growth. PNG is among a handful of nations that managed to sustain significant growth levels in the wake of the Global Financial Crisis in 2008-09. We continue to maintain that record even though key commodity prices have fallen considerably in recent years.

With the US\$19 billion PNG LNG Project in the construction phase from 2010 to 2014, the O'Neill-Dion Government charted out bold and ambitious plans for future development, taking into consideration the declining economic stimulus from the completion of the construction phase of the LNG venture.

Besides implementing policies for free primary and secondary school education and free basic public health programs, it formulated a large infrastructure development program encompassing roads, ports and airports, along with substantial direct funding of Provincial and Local Level Government to bolster grassroots provision of infrastructure and services in every district in the country.

These programs were implemented with a clear understanding that public sector programs would take up the slack in economic activity with the ending of LNG construction activity. The LNG project has been the significant pillar of economic growth and this stimulus was ending since around 2013. The project provided billions of kina worth of activity for many landowner and other PNG companies and had been the single biggest generator of jobs growth.

Mr Speaker, the O'Neill-Dion Government consciously decided on a counter-cyclical strategy to prevent a sudden slowdown in the economy. It was decided that the 2013 and 2014 budgets would see the implementation of large deficit budgets to provide the necessary economic stimulus. The 2013 budget had already spelled out the Government's intention to implement deficit budgets until 2017 with the expectation that new sources of revenue and growth would kick in by 2018.

The government is working to create an improved climate for growth of the private sector, including a new policy platform that will encourage the formation of Public Private Partnerships (PPP). These initiatives will also stimulate growth of Small and Medium Enterprises (SME's), particularly in the agriculture sector, thereby creating improved prosperity in the rural areas.

The big surge in formal sector employment over the past decade has contributed to a growing middle class which, through families and other ties, could generate growth that is more inclusive in nature, a trend that the government would like to encourage.

As a diverse nation with strong regional traditions and cultures we have a rich heritage to protect and nurture. At the same time we need to face up to our many challenges, particularly on the economic and development

front, where many more opportunities need to be created so that our people can enjoy improved living standards especially in rural areas, where the majority of the population reside.

2014 SUPPLEMENTARY BUDGET

Mr Speaker, Honourable Members, with those introductory remarks I would like to introduce the 2014 Supplementary Budget and to explain why it has been necessary.

Many of you will recall the controversies that were generated in the media and elsewhere , with the release in July of Treasury's Mid-Year Economic and Fiscal Outlook where National Government revenues were anticipated to drop by an estimated K350 million, largely as a result of falling revenues caused by declining commodity prices.

Commentators discussed the risk of a blowout of the planned deficit. However, at the current time it has become clear that improved personal and company tax receipts, along with benefits flowing from the early start of LNG exports, has kept the deficit more or less in line with the original budget forecast.

On the expenditure front, additional spending had to be faced to the tune of K897 million. Among the big ticket items was an additional K250 million for infrastructure for the 2015 Pacific Games, K250 million for personal emoluments and additional interest costs of K204.3 million as a result of rising interest rates for public sector debt raised mainly by the Central Bank.

With overall Government revenue falling from K12,688.5 million to K12,674.8 million, a drop of K13.7 million from the original budget

estimate, corrective measures were needed in view of rising expenditures and the failure of asset sales meant to bring in K600 million.

This was partly offset by K416 million in contributions from the National Petroleum Company (NPCP) and Ok Tedi (K190 million) plus dividends from statutory authorities, including Bank of PNG (K120 million), MVIL (K100 million), National Fisheries Authority (K50 million) and National Gaming Board (K50 million).

To prevent a budget blowout and safeguard the Government's economic management credentials, budget expenditure cuts of K1.07 billion were made in areas where public service delivery would not be adversely affected. This ensured the integrity of the 2014 budget was maintained.

As a result, the overall 2014 budget deficit increased by K77.2 million to K2,430.2 million from the original budget estimate of K2,353.0 million. The total deficit remained at the previously projected level of 5.9% of GDP.

I am sure Honourable Members will recognise this as a good outcome especially in view of the headwinds we have faced from a slowing global economy and declining mineral commodity prices. It also signals the need for caution and for the Government to stand ready to undertake corrective action in the face of unforeseen international and domestic developments that may affect the PNG economy.

Mr Speaker you will recall that earlier in the year the opportunity to purchase Oil Search shares arose and the O'Neill-Dion Government made a decision to purchase a 10.1% stake in Oil Search. As part of the 2014 Supplementary Budget and in accordance with Section 209 of the Constitution we have appropriated for interest payments and it is

anticipated that in the next month National Petroleum Company of PNG will refinance this transaction and take ownership of the shares.

Significant Budget reforms will guide the 2015 Budget to ensure a more effective, strategic and transparent budgeting process that demonstrates a clear link between the allocations of resources to the policies, plans and priorities of the Government.

Continued reforms include efforts to better integrate the Capital Budget with the Operational Budget to ensure more satisfactory interaction between departments and agencies responsible for key development outcomes.

Much more work also needs to be done on the 2014 initiative involving the five-year Multi-Year Budgeting framework, along with sector-led budgeting that gives priority to projects and activities with demonstrated outputs, outcomes and impacts.

In addition, the 2015 Budget will introduce a Public Sector Program Efficiency Review led by our Prime Minister and myself in my capacity as the Treasurer. The review will look into public sector operations starting in 2015 to ensure there is value for money from all government expenditure, elimination of wasteful spending and unnecessary duplication in National, Provincial and LLG activities. The Efficiency Review aims to improve the overall efficiency and effectiveness with which government services and projects are delivered.

The Budget is presented on a sectoral approach, comprising Administration; Economic and Agriculture; Education; Health; Infrastructure; Law & Order; Provinces and Social.

This will give the Government and the people of Papua New Guinea the clearest picture yet of where it is allocating its funds and which sectors are receiving increased funding over time.

The Government will continue to strive for a stronger economy through diversification of activities and by translating past, present and anticipated future gains from the mining and resources sector into prudent and sustainable investments in other sectors such as education, health, law and order, energy, transport, tourism and agriculture.

THE 2015 NATIONAL BUDGET

Hence, the theme of the 2015 national budget is, **“Building our Nation and Providing Opportunities for our People”**.

Mr Speaker I now turn to the 2015 National Budget, which has elicited much comment and controversy in recent months, largely as a result of over-exaggerated fears about the 2014 Supplementary Budget.

In line with the theme for the 2015 Budget the Government is making historic investment decisions from a position of economic strength while continuing to fund key development programs to meet the development needs of our country.

Mr Speaker, international and domestic economic conditions will always play a pivotal role in the economic fortunes of individual countries and provide a vital backdrop for the formulation of the budget.

These economic conditions will generally set the parameters under which the budget priorities can be planned.

ECONOMIC UPDATE

International Economic Outlook

So Mr Speaker let me set the scene by discussing the international economic outlook.

As Honourable Members would be aware PNG had the privilege last month of chairing the annual meeting of the Boards of Governors of the International Monetary Fund and the World Bank. The meeting in Washington was attended by 188 member countries of the premier International Financial Institutions and the overall mood can only be described as *cautious*.

The Managing Director of the IMF, Madam Christine Lagarde, spoke of the fragile nature of the global economy with significant downside risks at the present time even though the US economy has been showing a significant recovery from the Global Financial Crisis of six years ago. By contrast a great deal of uncertainty surrounds the European Union, where the leading economy, Germany, narrowly escaped entering into recession. Growth is also slowing down in China as well as in many emerging market economies, including Brazil.

The President of the World Bank Group, Dr Jim Yong Kim, who has been carrying out a major restructuring of World Bank operations, spent a significant amount of his speech discussing the dangers of the Ebola outbreak in the African continent and to the global economy.

Both leaders were also strongly of the view that climate change was another issue of utmost global importance that needed speedy action from governments around the world.

The IMF and World Bank have reduced their forecasts for the World Economic Outlook from a projected 3.6 per cent level in April this year to 3.4 per cent in July and to a current projection of 3.3 per cent growth in 2014.

They were of the view that global economic growth in 2015 would increase to 3.8 per cent because of improving performance of the US economy and some emerging and developing economies.

With growth prospects appearing to dampen even further in recent weeks we have seen gold prices drop to less than US\$1,200 an ounce while oil is hovering around the US\$80 a barrel mark, both of which are at four year lows. As Honourable Members would appreciate these are critical commodities for the PNG economy especially with the trend of easing mineral prices appearing likely to be sustained into the coming year.

Domestic Economic Outlook

Mr. Speaker, let me now turn to the Domestic Economic Outlook and report on how our economy has been performing under the stewardship of the O'Neill–Dion Government.

Mr. Speaker, the Papua New Guinean economy is expected to grow strongly by 8.4 per cent in 2014. This is higher than the 6.2 per cent projected at the time of 2014 Budget and the 5.4 per cent projected during the Mid-Year Economic and Fiscal Outlook (MYEFO) report. This upward revision is due to the impact of the early commencement of LNG gas production and export. Other contributing factors include favourable gold production from one of the major mines and a rebound in copra production due to high copra prices during the second half of 2014.

Despite these positive developments, non-mining GDP is expected to only grow at 1.4 per cent in 2014 down from 4.9 per cent in 2013. The downgrade is due to the slowdown in domestic economic activity as the economy descends from LNG related peaks associated with the completion of the PNG LNG construction phase.

It is anticipated that the flow on impacts of the government's fiscal stimulus put in place in the 2014 Budget would fill some of the gaps created by the end of PNG LNG construction. This has indeed been the case, however capacity constraints and delays associated with the implementation of some projects has been a major concern over the course of the year.

Therein lies the challenge for implementing agencies. This is the main reason why the O'Neill-Dion government is introducing the Public Sector Program Efficiency Review in this Budget to ensure that there is value for money from all government expenditures.

Mr. Speaker, in 2015 our economy is projected to grow significantly at an historically high growth rate of 15.5 per cent driven by a full calendar year of gas production and supported by a rebound in the non-mining sectors. This will be the 14th year of uninterrupted economic growth which is a huge achievement for a small country like PNG. While this is a very strong rate by any standard, it is nevertheless a downward revision from the 2014 Budget forecast of 21.2 per cent. This revision is due to the impact of early increased PNG LNG production in 2014 that has lifted the level of GDP in 2014 and reduced the GDP figure in 2015. 2015 will represent the first full year of LNG production and exports.

Mr. Speaker, credit should go to Exxon Mobil, its venture partners, the government of the day, and stakeholders such as the landowners for delivering ahead of time such a huge achievement for PNG.

- ***The Kina has stabilized and will gain in strength next year.***

Mr. Speaker, turning now to the exchange rate.

There have been a lot of concerns and criticisms raised by the public and business houses regarding the Kina exchange rate.

The facts are that the Kina has depreciated against its major trading partners, with falls against the US and the Australian dollars. On average, the Kina has depreciated by 8.3 percent against the US dollar and 3.0 percent against the Australian dollar from January to October 2014 compared to 2013.

The depreciation is attributed mainly to higher foreign exchange outflows for import payments, repayment of foreign loans and dividends payments and also reflects developments in the economies of our major trading partners.

Currently the US dollar is recovering as the US economy improves, which results in the Kina falling against the US dollar.

Mr. Speaker, I would like to assure all stakeholders: including the Government, business houses, investors, financial institutions, donor partners, individuals both citizens and foreigners that the Government through the Bank of PNG in consultation with commercial banks have put measures in place which have seen the Kina's value stabilised. This includes the exchange rate trading band that was introduced in the middle of the year.

Therefore, there should not be any cause for concern as the key fundamentals such as underlying economic growth continue to be strong and are supported by buoyant private sector business activities.

In addition the recent depreciation of the Kina has delivered benefits to PNG exporters by making the price of their goods more competitive internationally.

Going forward, the value of the Kina is expected to strengthen when proceeds from PNG LNG exports starts' flowing into the country.

The Bank of PNG will continue to assess developments in the foreign exchange market and work closely with the Government to manage the situation.

- ***Strong economic growth translates to strong employment***

Mr. Speaker, turning now to employment, strong economic growth translates to strong employment growth. I wish I could be specific, and talk about the actual number of jobs created, but these economic statistics are not readily available. We are presently addressing the challenge of improving our data collection efforts.

I can report that there is very good news for employment in the non-mining sector, the sector most of our people depend on. Based on through-the-year growth figures, non-mining sector employment grew by 3.0 per cent through to the end of the June quarter 2014. The growth in the non-mining sector is underpinned by sustained demand for skilled labour mainly attributed to increased business activities.

However, the bad news is that employment in the mining sector has declined. Based on through-the-year growth figures, the mining sector

employment declined by 22.7 per cent to the end of June quarter 2014. This is due to the slowdown in mining sector activity in the face of rising production cost following low commodity prices. It also reflects a period of re-alignment in the economy after the absorptive impact of the just completed PNG LNG construction phase.

- ***Maintaining a low and stable level of inflation is our priority***

Turning to inflation, at the last Budget, Treasury projected inflation to be around 6.5 per cent in 2014, reflective of the Government's stimulus spending.

The good news is that this has been revised down to 5.9 per cent after taking into account the manageable 2013 inflation outcome of 5.0 per cent, weak global economic activities, falling commodity prices, low inflation in major trading partner countries and the easing of aggregate demand associated with the completion of the PNG LNG construction.

Mr. Speaker, let me also inform this house, the business community and our people that the inflation figures that I presented is based on the New updated Consumer Price Index that the National Statistical Office (NSO) released early this year.

In 2015, inflation is expected to ease to around 5.5 per cent reflecting the expected revenues from PNG LNG in the latter half of 2015. This should translate into a stronger Kina exchange rate, thereby reducing the cost of imported goods and services. Other developments also expected to reduce prices include the second phase of the Tariff Reduction Program (TRP) expected in 2015. Over the medium term, from 2016 to 2019, inflation is expected to average around 5 per cent on the assumption of effective and coordinated monetary and fiscal policies.

- ***Papua New Guinea's current account moving into surplus***

Mr. Speaker, the good news on the balance of payments is that, PNG's trade with the rest of the world has improved in 2014 despite weak global demand and the uneven global recovery.

The improvement in exports has resulted in the current account balance narrowing to a deficit of K1.4 billion (or 3.4 per cent of GDP) in the first half of 2014 compared to a large deficit of K3.9 billion in the corresponding period of 2013. This improvement reflects huge surpluses in the goods and transfer accounts, partially offsetting the deficits in the services account and income account.

Mr. Speaker, despite the improvement in PNG's trade activity, the impact on international reserves is minimal given the low commodity prices that have translated into lower export receipts and high import demand. In addition, the size of foreign direct investments has fallen considerably since the completion of PNG LNG construction while foreign exchange outflows have increased due to a rise in import demand. This has triggered a fall in international reserves by 10.6 percent from K6.8 billion at end of December 2013 to K6.1 billion (US\$2.5 billion) as at 25th September 2014. By the end of 2014, the level of gross foreign exchange reserves is projected to rise to K6.4 billion (US\$2.6 billion), sufficient for 4.6 months of total and 7.8 months of non-mineral import covers.

In 2015, the current account balance, which had been in deficit over the last six years, is projected to move to a large surplus of K7.1 billion or 14.0 per cent of GDP from a revised deficit of K1.03 billion estimated for 2014.

This huge surplus in the current account is largely driven by a full calendar year of LNG production and the ramping up to full production of the Ramu Nickel mine in 2015.

In addition, a rebound in production is expected from the agriculture and mining sectors in 2015 following disruptions encountered in 2014.

Mr. Speaker, it is important for this Honourable House and the people of Papua New Guinea to understand the strategy contained in this historic budget. I will now take you through the strategy.

The proposed 2015 Budget is guided by the Government's economic development policy framework, including:

- Vision 2050;
- PNG Development Strategic Plan 2010-2030;
- the Medium Term Development Plan 2011-2015;
- the Medium Term Fiscal Strategy 2013-2017 (MTFS); and
- the Medium Term Debt Strategy.

These are further supported by the Papua New Guinea Fiscal Responsibility Act, 2006 (FRA).

These plans and strategies provide an on-going template for tomorrow's success.

FISCAL UPDATE

Mr. Speaker, I am proud to announce the fiscal position of the 2015 National Budget.

The 2015 Budget will result in a deficit of around K2.3 billion, or 4.4 per cent of GDP, and is largely driven by a 7.2 per cent increase in

nominal GoPNG expenditure. While expenditures have gone up by more than 7 percent, total Revenue and Grants are expected to increase by around 10 percent in 2015. This has resulted in a manageable debt level with Debt to GDP ratio of 27.8 per cent, significantly below the limit of 35 percent set by the Fiscal Responsibility Act.

Revenue and Grants

Mr. Speaker, Total Revenue and Grants in 2015 is anticipated at K13.9 billion.

This is K1.3 billion or 10 per cent higher than the 2014 revised estimates of K12.7 billion.

The higher 2015 revenue estimate is expected to be driven by tax receipts on income and profits, taxes on domestic goods and services and tax receipts on international trade. The increase in tax receipts on income and profits from the Mining and Petroleum Tax (MPT) has been due to the PNG LNG project. This will offset lower MPTs from existing mines which are facing downgrades to production, falling commodity prices and Infrastructure Tax Credits (ITC), which represents revenue foregone to the Government.

There are also additional compliance measures that is expected to raise K380 million by Internal Revenue Commission (IRC).

Tax Revenue is estimated at K11.2 billion in 2015, an increase of K1.5 billion or 15 per cent from the 2014 revised estimate of K9.7 billion.

This increase in tax revenue is a significant achievement by the O'Neill-Dion Government as it is built on sound economic growth and improved tax compliance measures.

Mr. Speaker, this Budget introduces five major revenue policy measures along with a number of minor policy measures and technical amendments. These measures combined, are expected to bring in K81.8 million in revenue for the government in 2015.

Whilst Tax revenue receipts are expected to increase in 2015, Non-Tax revenue receipts are expected to decline by a total of K129.9 million or 10.9 per cent from the revised 2014 estimate of K1.9 billion. The decline in Non Tax Revenue is because of lower dividends from State owned entities in 2015. State owned entities are expected to pay a total of K80.0 million – K20 million from Bank of PNG; K10 million from IPBC, National Fishery Authority - K25 million and Motor Vehicle Insurance Limited - K25 million.

Mining Petroleum and Gas Dividends, a component of Non Tax Revenue, is anticipated to be K698.5 million with the bulk contributed by LNG dividends.

Project Grants are estimated at K1.3 billion in 2015, a decline of K200 million from the 2014 revised estimate of K1.5 billion. Mr. Speaker, Project Grants are subject to discretion of Donors and exchange rate fluctuations which are beyond our control.

Revenues from mining and Petroleum companies will be reduced by K207.8 million in 2015, as a result of allowances for Infrastructure Tax Credits.

Expenditure and Net Lending

Mr. Speaker, the Government's spending priorities in the 2015 Budget include:

- Enhance opportunities for our people by improving the investment climate of our country while recognising the need for macroeconomic stability by progressively returning to a balanced budget in 2017, one year earlier than the original time frame.
- Further promote the efficient and effective implementation of major projects through improving designing, scoping, and implementation processes as well as open and competitive tender process.
- Increase direct funding to Provinces and Districts with more emphasis on monitoring, evaluation and compliance so as to achieve improved development outcomes.
- Continue to support policy priorities in Education, Health, Infrastructure, Agriculture and SME.
- Continue to strengthen the Justice sector, adequately resource Corrections Services, modernise the Police force and rebuild the Defence Force.

The prioritisation of spending in this Budget reflects the Government's focus on delivering against the current Medium Term Development Plan 2011-2015 (MTDP) through continued investment in the following key enablers:

- unlocking land and providing affordable housing for the public;
- improving law, order and justice;
- establishing quality national transport corridors that connect rural populations to markets and services;
- improving higher and technical education and training to redress the severe skills shortage in the labour force;
- providing universal access to primary and secondary education;
- provision of key utilities of electricity, clean water and sanitation and communications;

- improving primary and preventative health outcomes; and
- enhancing responsible sustainable development.

The total estimated expenditure of K16,199.1 million in 2015 includes operational spending of K9,213.5 million and capital expenditure of K6,985.5 million. While capital spending remains at historically high levels, the unprecedented growth achieved in 2014 cannot, and should not, be expected to be sustained on an ongoing basis. This Government recognises that, over time, major investment in capital infrastructure must be accompanied by growth in operational budgets to ensure those investments are sustained and the expanded capacity is fully utilised to deliver improved services.

Some of the largest spending commitments include:

- additional direct support for sub-national infrastructure through the new District Education Infrastructure Program **K267 million** and District Education Infrastructure Program **K178 million**;
- Roads and Bridges funding **K1.1 billion**;
- Universities and Colleges Infrastructure **K182.5 million** ;
- Continued roll-out of Tuition Fee Free Education **K650 million** (inclusive of trust funds);
- Hospitals Redevelopment **K308.9 million**;
- Agriculture/SME Development **K150 million**;
- Housing and Land Development **K70 million**;
- Completion of facilities for the 2015 Pacific Games **K360 million**, in addition to **K250 million** advanced in the 2014 Supplementary Budget;
- Increased allowances for Local Level Government Officials **K48 million**.

FUNDING BY SECTOR

- ***Infrastructure***

Total infrastructure sector funding of K2,298 million across the Infrastructure sector will be used for various roads and bridges, infrastructure rehabilitation and completion of facilities for the 2015 Pacific Games. The majority of infrastructure funding is through the Department of Works and Implementation (K1,194 million).

The Government is committed to improving the transport sector to establish an investment platform as a basis for sustainable economic growth and effective social service delivery in PNG.

The Government is investing K151 million in Air transport infrastructure and K50.8 million in Maritime transport infrastructure. Investment in our roads is also substantial under this Budget with National Highways (K238.9 million), Highlands Highway (K150 million) and City Roads (K293 million).

- ***Education –Our Future***

Total funding for the Education sector in 2015 will be K1.9 billion.

The Department of Education will receive funding of K1,140.0 million in 2015 which furthers the current Government's considerable commitment to education. The subsidies paid to support the tuition fee-free policy continue to be a major but essential cost (K605.0 million plus existing funding in trust accounts) to promote both increased school enrolments at elementary and primary levels and improved retention rates at higher levels.

The Government recognises the implications of the fee-free education policy and is providing additional funding to the Department of Education and the Provinces for the recruitment of additional teachers and to meet the cost of the recent large increases in teachers' awards and allowances (approximately 10%).

In 2015, a total of 18,232 schools will be beneficiaries of tuition-fee free education policy. This includes: 11,093 Elementary Schools, 6,453 Primary Schools, 410 High Schools, 228 Vocational Schools, 2 FODE Schools, 8 National High Schools, 30 Permitted Schools and 8 Special Education Schools.

In addition to this a total of K70 million will be provided for Curriculum Development Materials which includes the procurement of text and resource books for teachers in elementary and primary schools; K12.2 million will be provided for National Examinations to cater for grade 8, 10 and 12 examinations in 2015 and K11.7m for secondary school equipment.

The Government is continuing to improve access to higher education by providing 10,300 TESAS scholarships and by introducing a student loans scheme. At the same time the Government is providing wide-ranging support for the overdue rehabilitation of the nation's higher education infrastructure with K62.5 million provided for seven universities, K40 million for thirteen Technical Colleges, K40 million for eight Teachers' Colleges and K40m for eight Nursing Colleges.

- ***Improving Health Outcomes***

The Health sector encompasses the Department of Health as well as delivery and research agencies including Hospital Management Services and Provincial Health Authorities.

In 2015 total funding for the sector will be K1.8 billion. The Government will continue to subsidise free health care in 2015 at a cost of K20 million, support the creation of four new Provincial Health Authorities in West New Britain, Manus, Enga and Sandaun at a cost of K75.4m, fund rural primary health service delivery K25.2 million, and, as I noted, will provide K40 million for rehabilitation of eight Nursing Colleges.

The Government is committed to rebuilding and/or rehabilitating our hospitals. In 2015 a total of K216 million will be provided for major works at the Angau Memorial Hospital and the New Enga Provincial Hospital. A further K93 million will be distributed for capital works across the remaining Provincial Hospitals.

- ***Law and Order***

The Government will provide K1.6 billion in 2015 (including K66 million in donor grants) to the Law and Order sector. The major recipients of the increased funding in 2015 Budget are the Departments of Police (K367.2 million) and Defence (K261.2 million). In total K15.2 million has been allocated to recruit 480 new Defence recruits, 750 new Police recruits and 200 new CIS recruits.

Major investments in the law sector include the PNG – Australia law and Justice Partnership (K55.7 million), Waigani Court House Complex (K180 million) and Services Improvement Program (SIP) contributions to the sector of K127 million. The Government will also provide K30 million to Police, Defence and Correctional Services, in addition to K28 million

provided in 2014, to meet the costs associated with providing security services for the 2015 Pacific Games.

Some other drivers of the investments in the legal sector include an increased numbers of Judges and increased court circuits held in the provinces and districts and increased payments to village court officials from seven to eleven officials per court at a cost of K14.4 million.

- ***Provinces***

The 2015 Budget will see a further enhancement of funding reforms introduced in 2013 which saw a major increase in the direct funding to sub-national levels of government. Funding will increase to K3.7 billion and additional resources will also be available from the District Education Infrastructure Program (K267 million) and District Health Infrastructure Program (K178 million). While funding will initially be appropriated through the Dept of National Planning these new programs will provide K3 million per district and K2 million per district respectively for local infrastructure in health and education priorities. As the funding is tied, the expenditure is listed in the tables for those sectors.

The funding for the Provinces includes the ongoing K1,492.0 million per year in direct funding based on K5.0 million per district for the Provincial Services Improvement Program, K10.0 million per District under the District Services Improvement and K100,000 per Local Level Government. With the removal of fixed sector allocations, Provinces and Districts now have greater flexibility in utilising this funding to address local development priorities.

The operating budgets of Provinces will also be increased, in many cases substantially, to enable the recruitment of more teachers and health

workers and to assist in meeting the increased costs arising from substantial award increases in 2014 and 2015.

In respect to Public Servant wages the budget makes allowances for the new Public Service Pay Fixation Agreement (PSPFA) 2014-2016. Starting this year, the Government has allowed the 7.5 percent increase in the Public Servant wages to continue for the next three years. This will ease the burden of hard working public servants from additional inflationary pressures.

Whilst the Government welcomes increased salaries for our public servants, the National Government is committed to making the Public Service more efficient. Over the last four years the size and structure of the National Government and sub-national governments has changed considerably, as the Government has moved to devolve service delivery. There is now more money being given to, and services being delivered by sub-national governments than ever before.

It is timely to consider the costs, efficiency and functions of the Public Sector; and to examine if the balance is right between the National and sub-national levels of government. The Efficiency Review will report on efficiencies and savings to improve the effectiveness of, and value-for-money from, all Government expenditure across the forward estimates and in the medium term.

Financing

Debt Reduction

The 2015 Budget deficit of around K2.3 billion, or 4.4 per cent of GDP will be more than offset by proceeds from the sale of equity in the LNG project to landowners. The decision by the Government to proceed with the

transaction and use the proceeds to retire debt this year means that the estimated level of debt will fall by K228 million to K14.26 billion by end 2015. This will have a positive impact on reducing the Government and private sector interest borrowing costs.

In 2015, and pending the timing of the finalisation of the sale process, Treasury will continue its task of raising funds from the market to finance the deficit. Next year's National Budget will be financed through a combination of loans from our development partners (K0.8 billion), who continue to provide valuable assistance to PNG, and the remainder through our domestic market (K1.5 billion). Domestic debt will be retired as soon as the Government receives the proceeds from the equity sale.

Mr Speaker, the Government has always had a strong preference for utilising the domestic debt market where possible, but the time has now come for the Government to explore ways to increase its investor base and range of financing options. A growing economy needs to be supported by an equally vibrant and mature debt market capable of meeting PNG's future needs to fund projects and its development needs.

The Government's goal of achieving balanced budgets from 2017 onwards provides the appropriate platform to further reduce the level of debt to GDP ratio. This key measure of debt sustainability is expected to fall to 27.8 per cent next year, rise slightly to 28 per cent the following year and fall to 23.6 per cent by 2019. Even with the inclusion of outstanding superannuation liabilities of K2.1 billion, this ratio still remains below 30 per cent. This sustained reduction in the level of debt to GDP confirms the Government's underlying commitment to the Medium Term Fiscal Strategy and Fiscal Responsibility Act.

Economic and Financial Sector Reforms

- **Tax Review**

Mr. Speaker, I am pleased to update this House on the progress of the Tax Review Committee. The establishment of the Tax Review Committee in 2013 demonstrated the commitment of the O'Neill-Dion Government to undertake substantial economic reform. It is the first major review of the revenue system in over 13 years. It is timely given the substantial economic and social changes in the country since then.

It is critical that PNG has a revenue system in place to enable it to effectively meet social and economic challenges now and in the future. It will ensure that PNG is able to raise the necessary revenue to allow the Government to improve essential services and build the infrastructure necessary for growth and development of PNG. A modern and effective tax system is a critical part of PNG's efforts to become a competitive middle income nation in the Asian Century and to achieve other aspirations as envisaged in the Vision 2050.

Update on the Tax Review

Since the Review was formally launched in September 2013, significant progress has been made. Three issues papers have been released with a further three to be released by the end of the year.

I am pleased by the significant level of interest generated in the Review. Broad engagement is crucial in ensuring that recommendations are well informed and also that any subsequent reforms are sustainable.

Already the Review has received around 70 formal submissions with well attended regional consultations held in Lae, Kokopo and Madang. The engagement of the National Research Institute in the Review process has

been particularly welcomed, with a tax symposium co-hosted by the NRI and the Review Committee earlier in 2014 giving international and local academics an opportunity to provide input into the Review.

In recognition of the value of the consultation processes to date, the Government has agreed to extend the timeline by a further three months, with the Review to be finalised by 31st July 2015.

The O’Neill-Dion Government is looking forward to receiving the final report.

While the Government is not undertaking major tax reform prior to consideration of the tax review, the Government has put in place stringent compliance measures and has encouraged the Internal Revenue Commission and PNG Customs to improve their revenue administration.

Likewise, the Government is introducing reforms to the Research and Development and Infrastructure Tax Credit regimes to protect the revenue base from further erosion.

Earlier this year PNG took a significant step towards increasing transparency and accountability of revenues generated from the mineral and oil & gas sectors when our application for candidacy was accepted by the Extractive Industries Transparency Initiative (EITI) secretariat. Industry, Government and Civil Society will now commence the task of implementing EITI so that we can realise similar benefits to other resource rich participating countries – such as an improved investment climate, more informed public debate and enhanced management of resource revenues both now and for future generations.

Under the EITI, Papua New Guinea will report on revenue flows matching what resource companies pay with what Government receives. The EITI

report will also be a platform through which we can communicate to our citizens and the broader international community the amazing potential of our natural resources sector and the mature and responsible way we manage it. This is a considerable undertaking with the first report to be produced in 2015.

The Government also anticipates that EITI will set a platform for reforms in the extractive industries and other sectors as well.

- **Sovereign Wealth Fund:**

Mr. Speaker, turning now to the Sovereign Wealth Fund.

The importance of the PNG Sovereign Wealth Fund cannot be understated. It aims to ensure PNG's natural resource revenues are well managed, and support the economy and future development of our nation as envisaged in the PNG development strategies. The design of the PNG SWF is consistent with international best practice such as the SWF Generally Accepted Practices & Principles (Santiago Principles), the Extractive Industry Transparency Initiatives, and PNG's domestic requirements.

The current Organic Law of PNG SWF has been reviewed since its passage by Parliament in February 2012 to account for further refinements and technical issues of the constitutional law process. The Organic Law has been re-drafted with amendments to ensure it does meet all of the underlying policy objectives of PNG SWF and to further strengthen governance structures to ensure that the PNG SWF cannot be diverted in the future for purposes it was not intended for by Parliament.

Mr. Speaker, looking ahead, we recognise our mining and petroleum resources are limited and non-renewable. The Government had removed

the Development Fund and incorporated a Savings Fund for the purpose of saving mineral and petroleum taxes and dividends. This change does not affect the core institutional and operational structure of the PNG SWF. However, it does require alterations to the mechanisms for the flow of funds to properly account for the changed intention. Notwithstanding this change, there will be a single governance framework for the PNG SWF, but this incorporates two funds – a Stabilization Fund and a Savings Fund.

Mr. Speaker, the Stabilization Fund can help everyone in PNG. It will ensure a steady stream of revenues to the government budget for social and development spending. It will help protect PNG's economy from the volatility and uncertainty in global markets. Without it PNG risks being caught in the cycles of boom and bust, and not making the most from our resource wealth.

The Savings Fund will provide a means of preserving the real value of extracted mineral and petroleum resources through long-term investment for the benefit of current and future generations of PNG citizens. This work is critical to improving the lives of everyone now and the generations to come.

The overall objectives of the PNG SWF are to:

- support macroeconomic stabilization;
- promote intergenerational equity; and
- support asset management in relation to financial assets accrued from natural resource revenue.

Mr, Speaker the PNG SWF will be integrated into the budget and fiscal policy framework. The PNG SWF will operate and be governed within PNG with an independent Board that will invest the assets predominantly

overseas to help macroeconomic management and seek the best returns for PNG, but all spending will be in PNG through the Budget. This will avoid the dangers of the so called “Dutch-Disease”, ensure effective government spending of mineral and petroleum revenues and facilitate fiscal transparency and oversight of public finance management by Parliament.

The national budget will be accorded priority funding and will be linked by the deposit and withdrawal rules of the PNG SWF. The policy is intended to help achieve macroeconomic and financial system stability.

The Government will table this legislation in the next session of Parliament.

- **Financial Services Sector Review:**

Mr Speaker, I am also pleased to announce that in 2014 the Government made considerable progress in improving the financial literacy and financial inclusion of our citizens. The goal for the 2014-15 National Financial Inclusion and Financial Literacy Strategy is to reach one million more un-banked Papua new Guineans – we want at least 50 per cent of those to be women. I’d like to acknowledge the Bank of PNG and everyone involved in making the first year of this important initiative so successful – It is critical that we maintain the momentum in relation to this important reform.

The financial services sector review, which commenced this year and will conclude, next year, will identify policies and practices to assist in improving the efficient operation of this important sector and to ensuring greater access by our citizens.

The review will cover amongst other issues

- systemic risks in the financial sector;
- governance arrangements;
- how to utilise the financial services sector to improve the integrity of transfers between levels of Government and to citizens; and ;
- enabling the growth and expansion of a sound debt market (financial capital market)

The O'Neill-Dion Government strongly considers micro-economic reform to be the engine for sustainable growth of the private sector.

Accordingly, the Government will continue to pursue a comprehensive national micro-economic reform agenda in 2015.

The Government will prioritise competition policy, and looks forward to considering the reform options to be presented to Government in 2015 from the consumer and competition policy review. This review will consider how we can enhance consumer protection, and address barriers and impediments to competition, including those faced by women.

These findings will arm the Government with an ongoing program of reform to support ongoing efficiency gains and growth. I'm very happy to announce that there is a background paper now nearing completion that will be available on the Treasury website by the end of November setting out the process and objectives of the review in greater detail. A low-cost user-friendly business regulatory environment for local and foreign business investors will also continue to assist PNG to promote ourselves as an attractive investment destination.

The Government is about to undertake the largest restructure of the arrangements for holding and managing State assets since the establishment of the Independent Public Business Corporation in 2002.

The Kumul Consolidation Agenda (KCA) will manage all State assets including the State Owned Enterprises (SOEs) and mining and petroleum interests.

Sound and transparent management is critical to the success of the Kumul structure.

The Government will also undertake micro-economic reforms in SOEs.

The Government's reform efforts throughout 2015 will continue to promote more efficient State Owned Enterprises through policies that require them to operate in accordance with commercial principles. These principles include responding to shareholders expectation to receive dividends as a return on their investment. In the case of SOEs these shareholders are the people of Papua New Guinea.

- **Public Private Partnerships (PPPs).**

The Government recognises the important role the private sector can play in expanding service and infrastructure provision in PNG, including working with the State through public private partnerships (PPPs).

PPPs are a way to increase private sector involvement in the supply of public services. A key reform achievement for 2014 was the enactment of the Public Private Partnership Act 2014. We now have the legislative framework in place to commence realizing PPP opportunities in Papua New Guinea.

2015 will require the PPP regulations to be finalized and the establishment of the PPP centre in order to fully operationalize the framework. PPP is the Government's preferred model for approaching infrastructure and service delivery going forward. Not every project will lend itself to a PPP

arrangement but many will and we look forward to realizing the benefits of this approach as so many other countries have.

To harness this potential, the Government is examining the feasibility of a number of PPPs in the power and transport sectors.

It is important to emphasise that a PPP is simply a method to competitively procure, deliver and maintain infrastructure and services through cooperation between a public institution and one or more private enterprises via a long term contractual agreement e.g. to build and maintain a highway, or to plan and develop a large scale commercial agriculture project.

This additional PPP transaction expertise, combined with legislation that requires transparent processes to execute PPP arrangements be followed, should provide the private sector enhanced confidence to invest in PNG PPPs.

Improvement of Statistics in PNG:

Mr. Speaker, the need for reliable and timely statistics cannot be stressed enough and the O'Neill-Dion Government has made a serious commitment in 2014 to Reform the National Statistical Office (NSO).

The Government approved a co-sponsored submission on the Reform of Statistics in June for the NSO to immediately be reformed. This submission was sponsored by the Minister for National Planning and myself as the Treasurer.

A terms of reference was drafted and presented to an IMF/ABS High Level Mission in July to assess prior to them committing Technical Assistance to the Government's program.

It is understood that the IMF and Australian Bureau of Statistics (ABS) including key donors like the World Bank are pleased with the broad thrust of the government's plan and have officially announced they will provide Technical Assistance to reform NSO.

It is also understood that an ABS led scoping mission is already in PNG as I speak and have been working with the NSO and key stakeholders to scope out the reform package for the Government.

The Government is very serious about this reform and will provide the necessary resources to ensure that a workable implementation plan is devised to strengthen and build the statistical system.

The Government would also like to thank the IMF, the ABS and other donors for re-engaging with the PNG NSO. Let us work together to make this a reality.

Mr. Speaker, on any journey, it is important to have friends who will walk alongside you. PNG is lucky enough to have a number of friends who have joined us on the path to greater economic prosperity that we are currently treading.

For example in terms of grants in 2015;

- the Australian Government will provide K1.07 billion to PNG;
- the European Union K82.4 million
- the United Nations over K81.9 million;
- the Japanese Government K76.2 million
- the New Zealand Government K34.9 million; and
- the Chinese Government K15 million

In addition, the World Bank contributed K164.0 million in grants and loans and the Asian Development Bank will be providing loans for K376.7 million worth of mainly infrastructure projects and the Chinese Government a further K348.6 million.

There are a number of other partners too of course, with one of these being the International Monetary Fund which recently completed their Article IV economic assessment of PNG that supported the continuation of the O'Neill-Dion Government's fiscal and sound monetary policies.

It is worth noting that in their economic assessment of PNG, they commended the O'Neill-Dion Government for impressive achievements, especially the PNG LNG project. "The PNG LNG project has demonstrated PNG's impressive capacity to undertake large-scale commercial development. Looking ahead, the Pacific Games in 2015 and APEC in 2018 will further provide opportunities to showcase PNG's capabilities".

The O'Neill-Dion Government's commitment to sustainable budgetary reforms was acknowledged by the World Bank Group and the IMF through the appointment of PNG to chair the 2014 Annual Meeting of the Board of Governors in Washington DC, USA from 10-12 October 2014.

Mr. Speaker, it is a great honour for me personally and for Papua New Guinea to chair this most prestigious meeting in front of our global leaders. While chairing the meeting, I used this opportunity to promote PNG and the Pacific region and most importantly relay our concerns and challenges to the world.

This Budget must build the foundation for a strong and vibrant economy that will provide improved opportunities and higher living standards for the current and future generations

This Budget will help PNG overcome its development obstacles and create a more prosperous future for all of us.

I commend the 2014 Supplementary Budget and the 2015 National Budget to the House.

Thank you Mr. Speaker.