THE INDEPENDENT STATE OF PAPUA NEW GUINEA

2017 NATIONAL SUPPLEMENTARY BUDGET SPEECH

DELIVERED BY

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DEPUTY PRIME MINISTER AND TREASURER

On the Occasion of the Presentation of the 2017 National Supplementary Budget to Parliament

Thursday, 28th September 2017

Mr Speaker,

Its a great honour for me to stand here as Deputy Prime Minister and Treasurer to present this 2017 Supplementary Budget on behalf of our coalition government. The priorities of this government are represented in the Alotau Accord 2 and based on growing the economy sustainably and the empowerment of our people.

Honourable members, the first eight months of this year have been difficult and the economy has under-performed our earlier expectations as presented in the 2017 Budget. In particular, world economic growth was lower than projected and commodity prices did not resume upward trends. Following the impact of the El Nino drought and the persistently low oil and gas prices government revenues have declined, some of our operating costs continued to rise, and the foreign exchange imbalance has affected commercial activity levels and confidence.

The Government in response and to activate the Alotau Accord 2 has brought down a 100 Day, 25 Point Plan. This plan followed after extensive consultations with stakeholders from Government, the private sector, development partners and others such as the Institute Of National Affairs. This Plan presents 25 critical policy actions aimed at maintaining fiscal discipline, addressing the foreign exchange imbalance, enhancing revenues, strengthening our economic base and improving governance. It has received widespread support including from the private sector and the IMF.

Mr Speaker,

The 100 Day Plan commenced on the 24th of August following NEC endorsement. It is not intended to address every issue confronting us nor solve them within 100 Days. It does bring focus and commitment to a timeline. In fact I see a series of 100 Day Plans potentially Mr Speaker but only if the first one has some successful outcomes.

I will list some very specific NEC instructions and actions towards the end of this statement that come from the recommendations with the Supplementary Budget but for now after 25 Days I want to report that progress is being made on many fronts.

Mr Speaker,

We firstly had to actually construct the 100 Day and seek endorsement, we have the 2017 Supplementary Budget before us and the 2018 Budget consultations, Budget Strategy Paper and Budget proper are well under way.

There are several specific actions underway (some of which i will detail later) regarding government payroll excesses including an reconciliation process which is underway starting with the teachers payroll,

the drawdown of the second tranche of the Credit Suisse loan is imminent although it has been reduced to US$75m,

the negotiations with the World Bank for budget support for debt restructuring is on track to be included in the 2018 budget - I will be travelling to Washington to conclude these negotiations on the 9th of October,

ADB budget support to the health sector of US$300m over ten years will also commence next year together with US$1bn support for the highlands highway over ten years.

We have negotiated to have Oil Search provide 50% of the crude oil requirements of Napanapa Refinery in Kina rather than US$. Puma is the biggest individual consumer of forex in the market.

The Bank Of PNG has offered to support The Plan by an increased intervention in the forex market of 100mUS$ in the 100 Days,

regulations are being composed by Treasury and Finance to compel the remittance of 90% of revenue to consolidated revenue by non tax revenue collecting agencies of government,

revenue task forces have been established for Lands, IRC and Customs and Illicit Trade - The Lands Minister, The Treasurer and The Attorney General respectively are in charge of these teams,

the BPNG and IRC will be coming to the media shortly with announcements about compulsory Tax Identification Numbers for bank accounts and IPA registration of businesses, commercial banks will be required to report on personal and other bank accounts being operated as business accounts, the US$115m 58MW Pom gas powered plant is close to ground breaking stage, the US $500m Ramu2 Project is progressing to financial close by year end,

the 1762 allotment Gerehu 3B housing project stage one 300 allotments is having power and water put in as we speak,

the international submarine cable project which will be a game changer for communication costs in Png has a great offer for blended grant and concessional financing on the table from Australian Dfat and the World Bank,

royalty payments have commenced for landowners on the Png LNG Project,

and instructions have come from Cabinet to respective Ministers and Departments on the review of proposed amendments to the Lands, Mining and IPA Acts to alleviate private sector concerns and encourage investment,

a review by ICCC into rice pricing in PNG is underway and through the Agriculture Minister we are considering options for a policy and fiscal regime to support rice and stockfeed production in Baiyer, Sepik Plains and Central plains to push agriculture, food security and import replacement,

There is a Medium Term Revenue Strategy being developed in concert with the IMF primarily around reforms to the Tax System to strengthen and simplify it and improve revenue collection, and there will be certain measures in the 2018 budget to counter transfer pricing activities as a prelude to this.

Mr Speaker,

Let me now provide the background setting, impact on the 2017 Budget to date and the details of the 2017 Supplementary Budget.

STATE OF THE ECONOMY AND 2017 BUDGET

Mr. Speaker,

- The key outcomes of the 2017 Mid-Year Economic and Fiscal Outlook (MYEFO) Report were: Whilst our medium term prospects remain positive, our GDP growth in 2017 has slowed modestly from what was expected in the 2017 Budget due to the continuation of ongoing structural issues, weak recovery in commodity prices and a deepening of foreign exchange imbalances. The domestic economy is projected to grow at 2.7 per cent, slightly lower than the 2017 Budget estimate of 2.8 per cent;

- However, non-mining GDP growth is expected to improve slightly to 2.4 per cent against an initial budget estimate of 2.3 per cent; and
- Inflation is projected to increase from 6.7 per cent in 2016 to 6.8 per cent in 2017 following modest depreciation in the Kina exchange rate.

Mr. Speaker,

The revised lower real growth projection of 2.7 per cent for 2017 is largely due to lower than anticipated growth in output in the mining and agricultural sectors, with the oil and gas sector projected to contract by 0.5 percentage points in real terms. The downward revision reflects a benign world economy where gold and oil prices have not resumed clear upward trends, and where many of PNG's agricultural commodity prices (particularly coffee, cocoa and palm oil) have deteriorated further over the first half of 2017.

Mr. Speaker,

When this is coupled with a continuing tightness in the availability of foreign currency, then the deterioration in local business conditions over the year to date is apparent, which helps explain the shortfalls in expected company tax receipts, royalties' tax and gaming machine tax receipts in 2017 compared with budget. But mining is still projected to lift 12 per cent in 2017 following full year production from Ok Tedi and higher volumes from Ramu Nickel, although gold production is anticipated to be down from both Ok Tedi and Porgera.

Overall, the agriculture, forestry and fishery sector is expected now to grow at 3.2 per cent, which is slightly lower than the 2017 Budget estimate of 3.3 per cent. The downgrade reflects lower log production, the base effects of weaker growth in 2016 following the drought and some output effects from lower commodity prices.

Encouragingly, production of some agricultural commodities should reach expected levels due to improved weather and growing conditions. Palm oil production is expected to return to normal after the devastation caused by the El Nino weather phenomenon in

2015/16. The supply response from cocoa is expected to gain momentum with new areas coming into production especially in the Sepik province despite the sharp contraction in cocoa prices.

Copra production will continue to benefit from favourable prices, while coffee production is set to moderate in 2017 as the crop recovers from a bumper season in 2016. It is important to note that this outlook does not capture the possible adverse impact of the Coffee Berry Borer (CBB) due to limited data to date. Treasury understand that CIC and NAQIA are currently conducting a baseline survey to quantify the nature, size and impact of the infestation and the Government in this Supplementary has allocated some additional funds for this purpose.

Apart from the modest reduction in primary production, other non-mining output should reach budget estimates, being supported by election-related spending, APEC preparations and an expected easing of foreign exchange constraints over the final quarter of 2017.

Mr. Speaker,

Let me now report on the fiscal operations for the first half of 2017 as presented in the 2017 Mid-Year Economic and Fiscal Outlook (MYEFO) Report by the Department of Treasury.

The 2017 mid-year fiscal results showed a deficit of K784.4 million (or 1.0 per cent of GDP) bringing the total outstanding public debt level to K24.6 billion or (33.1 per cent of GDP). However, most of the increase in debt was due to the increase in the fiscal deficit late in 2016 and, therefore, was not captured in the 2017 Budget.

Total Revenue and Grants was K4.4 billion for the first six months which is estimated in MYEFO to result in a 2017 Outturn of K10.9 billion compared to the 2017 budgeted amount of K11.5 billion – a K514 million shortfall.

Therefore, Mr. Speaker,

As a responsible Government, we have decided to make the required downward adjustment to appropriated expenditures to ensure that the deficit remains at the budgeted level of K1.8 billion or 2.5 per cent of GDP. This will maintain the debt to GDP ratio at 32.1 per cent, down from the 2016 ratio of 32.4 per cent. And Mr. Speaker, the

Government is committed fully to implementing these adjustments to restore a prudent, responsible and sustainable fiscal path for the remainder of 2017 and beyond. Importantly it should be noted that many commodity-dependent exporting economies that have been hit hard by depressed commodity prices are experiencing slow growth, widening fiscal and external deficits, and some combination of exchange rate depreciation and decline in foreign reserves.

We are no exception – but how we have responded to this external shock has been widely commended by leading global financial institutions and rating agencies.

Mr Speaker,

On the other side of the ledger, total Expenditure and Net Lending over the first half of 2017 amounted to K5.2 billion, which is 39.1 per cent of budgeted expenditure. This low level of expenditure to date is largely due to Government's prudent management of warrant releases in response to both the shortfalls in revenue over the same period and the difficulties in reliance on the short term domestic money market for financing. There is liquidity in the monetary system but this in part reflects the pent up demand for foreign exchange.

The cautious release of warrants and prioritisation of expenditures remain crucial under declining revenue trends in order to reduce pressure on the Government's cash flow and ensure stability in domestic financial markets. The priority expenditures have been focused on essential services in Health, Tuition Fee Free Education, Law & Order, 2017 General Elections and key national infrastructure projects, as well as preparations for the 2018 APEC Summit.

Mr Speaker,

Despite tight warrant control over the year to date, if no adjustments are made, then MYEFO estimates show total expenditures increasing to K13.8 billion and with a further K370 million discovered subsequent to MYEFO, taking expenditures to K14.1 billion. This is K800 million higher than the 2017 Budget. The increase is attributed to, amongst other things, personnel emoluments - up K430 million, debt service – up K150 million, office rentals – up K50 million, pharmaceutical drugs – up K100 million, Department of works expenditures – up K51.2 million, and other expenditures up K18.8 million.

Together with the shortfall in revenue of close to K500m would mean that if the Government failed to act, the deficit would increase by K1.3 billion pushing out debt to GDP and the fiscal deficit significantly beyond the 2017 budget proper.

THE 2017 NATIONAL SUPPLEMENTARY BUDGET

Mr. Speaker,

I now turn to the 2017 Supplementary Budget.

The 2017 Supplementary Budget reduces anticipated revenue from K11,473.1m to K10,979.20m, a reduction of K494m in line with the MYEFO projections. Expenditure and net lending is then reduced from K13,349.5 to 12,855.60, a corresponding K494 reduction to maintain the fiscal deficit position of the 2017 budget.

On the expenditure side reductions of K25.784m to the recurrent budget, and K1,268.28m from the capital budget, totalling K1,294.064 is utilised to accommodate the K494m expenditure cut and a reappropriation to cover K800.1m in cost overruns.

Mr Speaker,

Its important to note that the 2016 Final Budget Outcome (FBO) resulted in a higher fiscal deficit of K3.1 billion (4.6% of GDP) against the planned deficit of K2.1 billion (3.1% of GDP) which has rolled into and affected the foundations of the 2017 budget .

Mr. Speaker,

We remain concerned about the rising cost of running government particularly the payroll and we are taking measures as explained in this statement, however, we recognise that adjustment to salaries and wages and most of the other operational expenditures in the short term are largely fixed, and therefore the main adjustments have to come from capital expenditures (PIP) and other development projects. Only a modest adjustment in operational expenditure could be achieved at this late stage of the year and because of a backlog from warrant restrictions and its impact on service delivery. These operational reductions mainly relate to the purchase of vehicles, and other operational expenditures.

To guide this process, the following key performance criteria were applied to the refocusing of capital expenditures (PIP) and other development projects. These were:

- projects with a relatively high rate of disbursement; and
- projects with donor counterpart financing, as these tend to have a high rate of disbursement and are focused on the development enablers.

In addition, Mr. Speaker, the 2017 Supplementary Budget also aims to limit spending on less productive capital expenditure as much as possible while safeguarding expenditure on maintenance. Furthermore, key policy platform priorities such as Tuition Fee Free Education, Free Primary Health Care and APEC preparations, as well as statutory funding such as public debt interest, remain unaffected.

Within the revised expenditure envelope, K800.1 million is reallocated to projected expenditure overruns to fund:

- K430.1 million for Personnel Emoluments;
- K150.0 million for Debt Service;
- K50.0 million for Office Rentals ;
- K100.0 million for Pharmaceutical Drugs;
- K51.2 million for Department of Works; and
- K18.8 million for other minor adjustments to allow for allocations to the Coffee Berry Borer Disease Response (K5.0 million), PNG Games (K4.0 million), IRC and PNG Customs Taskforce (K3.0 million), Payroll Audit (K2.0 million), Land Government Information System (K1.8 million) and Clan Vetting (K3.0 million).

Mr. Speaker,

This returns the 2017 Budget to its original fiscal anchors of a deficit of K1,876.5 million, or 2.5 per cent of GDP and a Debt to GDP ratio of 32.1 per cent of GDP. In this respect, the Government will be seeking an amendment to the Fiscal Responsibility Act to alter the 30 per cent to GDP debt ceiling to a range of 30 to 35 per cent to provide the Government with some flexibility to manage fiscal and financing policies through these protracted economic downturns. But it must be emphasised that, as an offset, the Government will also amend the Fiscal Responsibility Act to compel the Government in its medium term fiscal strategy to target the lower 30 per cent boundary and, additionally, to target an average non-resource primary fiscal balance of zero over the medium term and through the economic cycle.

Importantly this will facilitate the sustained build-up of resources in the Sovereign Wealth Fund once the resources cycle swings into an uptrend, thereby constraining Governments now and into the future from excessive spending in such upswings.

Mr Speaker,

In financing the Supplementary Budget, there is an urgent need to shift the financing burden away from the domestic security market to both reduce rollover risk and to facilitate the reduction in the foreign exchange imbalance. In this respect the Government has directed the Department of Treasury to finalise negotiations for the second tranche of the Credit Suisse loan and progress the issuance of the inaugural sovereign bond for Papua New Guinea.

THE 100 DAY PLAN

Mr Speaker, to support the Supplementary Budget measures and to progress the Government's reform agenda, the Government has issued a number of directions to departments and agencies in accordance with the 100 Day 25 Point Plan.

Specifically the Government has directed:

(i) the Chief Secretary to immediately establish an Office Allocation Audit Committee to undertake an audit of the office rental portfolio and report back to NEC by end of September 2017 on the relocation of Government agencies in rental properties;

(ii) the Departments of Finance and Personnel Management to cease the use of PGAS for the purposes of personnel emolument payments and report back to NEC through the Ministers for Finance and Public Service before 1 October 2017;

(iii) the Departments of Finance, Treasury and Personnel Management to commence the physical audit into the Government payroll, starting with teachers and incorporating the national identification registration and report back to NEC through the Minister for Public Service before mid-December 2017;

(iv) the Departments of Treasury and Finance in consultation with the Office of the State Solicitor, through the Ministers for Finance and Treasury, to present to NEC by the first week of October 2017 legislative instruments that:

i. cause all statutory authorities and other Government agencies collecting non-tax revenue under statute to remit 90% of those collections to Consolidated Revenue Fund; and

ii. allow for a review process involving both Departments of Treasury and Finance for those agencies in (i) to present a justified case for why a greater portion than 10% should be retained;

(v) through the Attorney General, the Office of the State Solicitor with the relevant client policy government agency, to provide a review report with recommendations on the appropriate policy and drafting changes to reflect stakeholder concerns on the proposed new or amending legislation for the Lands & Physical Planning Act, the Investment Promotion Act, the Agricultural Administration Adjustment Act, Agricultural Investment Act, the Biosecurity Act; the Mining Act and the Mineral Resources Authority;

(vi) Minister for Petroleum and Energy to bring to NEC the proposed Energy Authority Act for approval for submission to Parliament;

(vii) The Minister for Finance to review and bring forward the National Procurement Authority Bill to Parliament before the end of 2017;

(viii) There be no new tied financing after the 15 September 2017 and these arrangements be managed under the new National Procurement Authority and the Public Finances Management Act once the establishing Act is approved by Parliament and comes into force;

(ix) Ministers for Public Enterprises & State Investments and Commerce & Industry to provide a project delivery plan for the Pacific Marine Industrial Zone by end of November 2017;

(x) Department of Works & Implementation in conjunction with the Asian Development Bank to establish a Project Management Office for the Highlands Highway Rehabilitation Project by end of November 2017; and

(xi) Departments for Treasury and Public Enterprise & State Investments together with Kumul Consolidated Holdings Ltd and DataCo to revert to NEC with options for the financing of the POM – Sydney International Submarine Cable by 1 November, 2017.

Mr Speaker, the Government has also directed:

(i) that the Ministers for Finance and Treasury present by the end of September 2017, the close of 2017 accounts process to be jointly drawn up by the Departments of Finance and Treasury and that within this process all unspent appropriations lapse unless and only unless authorised by the Ministerial Budget Committee, chaired by Minister for Treasury with this to be reflected in the revised 2017 Budget Appropriation Acts;

(ii) that the Attorney General to review and report to NEC by 10 November 2017 on the Gas Agreement for the PNG LNG Project to determine if an expansion will be subject to the same fiscal terms;

(iii) that there be a freeze on new recruits and for the Departments of Personnel Management and Finance to report on the status of the migration of all Government employees onto the centralised Government payroll system by end of September 2017;

(iv) that the Organisational Structure & Personal Emoluments Audit Committee (OSPEAC) revert to NEC with a list of State Departments, Offices and Agencies identified for amalgamation by end September 2017; and

(v) that there are no tax credit project approvals until further notice.

CONCLUSION

In conclusion, Honourable Members, these fiscal and policy adjustments and actions that the O'Neill-Abel Government are undertaking are necessary to secure macroeconomic stability and a sustainable fiscal trajectory over the medium term wherein the Government's development priorities can be implemented and financed.

This more responsible and prudent approach to what are global shocks will underpin improved domestic and international market sentiment.

We believe that this Supplementary Budget and the associated 100 Day Plan and its series of actions presented will give confidence to our domestic and international investment partners such that they will continue to invest and provide enhanced opportunities and prosperity for our people.

By tabling the 2017 Supplementary Budget in September, our key stakeholders, the private sector and development partners, will be able to plan their adjustments more effectively in line with the Government's intentions and corrective policy measures.

The message is clear, Mr. Speaker, we have to "live within our means and continue to build the structures that will enable us to weather storms more effectively than we have in the past".

Mr. Speaker,

This Supplementary Budget and associated actions directed by the Government set the basis for the fiscal framework for the 2018 Budget and the Medium Term Fiscal Strategy which seeks to return debt levels to the previous 30 per cent of GDP ratio over the medium term and build resources in the Sovereign Wealth Fund once the resource cycle recovers. The Government has and will continue to conduct its fiscal policy within this medium term framework.

It also needs to be emphasised that a number of corrective measures that we have introduced in the 2017 Budget are being implemented and will be given impetus by the actions and directions presented and these will be continued into 2018.

These ongoing measures include:

- corrective measures to the expenditure side such as the amalgamation of departments and agencies, freezes on recruitment, and constraints on the high personnel emoluments costs; and

- corrective measures to the revenue side, including continuing our efforts to improve tax compliance, effectiveness of tax administration, and review of a range of excise charges and fees. The revenue announcements in the Government's 100 DayS Plan will be expedited. Further a substantive tax reform package will be presented in the 2018 Budget consistent with the Government's new Medium Term Fiscal Strategy 2018-2022 and New Medium Term Debt Strategy.

Mr. Speaker,

Honourable Members, I commend the 2017 National Supplementary Budget to the House.

HON. CHARLES ABEL

DEPUTY PRIME MINISTER AND TREASURER.