THE INDEPENDENT STATE OF PAPUA NEW GUINEA

2019 NATIONAL BUDGET SPEECH

"Building A Broader Based Economy"

DELIVERED BY

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On the Occasion of the Presentation of the 2019 National Budget to Parliament

Tuesday, 13th November, 2018

HON. CHARLES ABEL, MP

DEPUTY PRIME MINISTER AND MINISTER FOR TREASURY

INTRODUCTION

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

Mr. Speaker, Honourable Members, my fellow citizens of this great nation, on behalf of the O'Neill-Abel Government, I am pleased to present the 2019 National Budget under the theme: **"Building A Broader Based Economy".**

Mr. Speaker, firstly, our development journey continues to be guided by the groundwork laid particularly since 2011/12 under the leadership of Prime Minister, Hon. Peter O'Neill and the coalition agreement, Alotau Accord I.

Since returning to power in 2017 under Alotau Accord II, the new coalition Government responded to some difficult circumstances through the 100 Day/25 Point Plan to: "ENSURE SOUND MACROECONOMIC AND FISCAL MANAGEMENT, RESTORE CONFIDENCE AND GENERATE INVESTMENT by - MAINTAINING FISCAL DISCIPLINE, BOOSTING FOREIGN EXCHANGE, GROWING REVENUES, STRENGTHENING OUR ECONOMIC BASE, IMPROVING GOVERNANCE AND ACTING STRATEGICALLY.

The 25 Point Plan commenced with the 2017 Supplementary Budget which necessitated significant cuts to the capital budget to maintain the fiscal deficit and debt parameters of the 2017 Budget proper.

Mr. Speaker, the 2018 Budget, continued the reforms and I am delighted to report that we are continuing to make considerable progress as we implement the reforms of this Government.

Mr Speaker, We have been confronted with many obstacles since I brought down the 2018 Budget last year, particularly the devastating earthquake that tragically claimed so many lives, took away the livelihoods of families and communities, severely disrupted business and industry, and threatened a deep economic downturn. There was also the Kardovar volcano eruption and more recently the Manam volcano. So much so that the country's credit rating was downgraded as a result.

Mr. Speaker, in the face of those adversities, including the polio outbreak, we rallied together as a nation in support of the people affected, to minimise the broader impacts, and stay focused on our path to recovery. The performance of the 2018 Budget in the light of these circumstances has been quite remarkable Mr Speaker.

We have increased revenues under the Medium Term Revenue Strategy.

We have improved fiscal discipline under the Medium Term Fiscal Strategy.

And, we have restructured our debt under more favorable terms under the Medium Term Debt Strategy, maintaining this Government's commitment to a declining fiscal deficit and keeping debt within sustainable limits.

The reform strategies of this Government are working, Mr. Speaker, and they have provided renewed confidence in our economy. A key measure of this confidence are some examples of the investment decisions of our private sector over the last year, which included:

- The NBPOL acquisition of the long underperforming Markham Farms for USD $50 million, which with additional capital investment from 2019 is set to commence exports in coconut products, palm oil and other agricultural commodities;
- Over a dozen new small to medium local manufacturers opening for business;
- A number of well-established local manufacturers, including Coca Cola Amatil (PNG), Pacific Industries, Lae Biscuits, Mainland Holdings, Trukai, Innovative Agro Industries, commence major re-capitalisation and investment projects, with an combined investment value of more than K1.5 billion. Prior to 2018, a

number of these businesses had been reconsidering Papua New Guinea as a place to do business;

- The legacy investment in the banking and finance sector with the home grown Kina Bank buy out of ANZ's retail, commercial and SME businesses;
- The opening of the Star Mountain Hilton Hotel serving as a significant boost to the hospitality and tourism sector; and
- Port Moresby residents enjoying access to locally manufactured fresh dairy products for the first time, something that will extend to residents of Lae and Morobe in 2019.

Mr Speaker, It is critical that focus and discipline is maintained towards our strategy so that we are building that broader based, more resilient economy to protect our people and economy from economic and weather or geophysical shocks.

Together, these measures provide for sound macroeconomic and fiscal management, to keep building confidence in our economy, increase and diversify investment, replace imports, boost exports and reduce reliance on debt, in order to deliver better social services, infrastructure and employment and business opportunities for the people of Papua New Guinea. All of which are consistent with the aspirations of our people as articulated through the National Planning Framework, including Vision 2050, StaRS and the Medium Term Development Plan III (2018 - 2022).

Importantly, Mr. Speaker, this Government's reform agenda has led to unprecedented success in achieving our ambitious international financing plan. Raising US$500.0 million through the inaugural 10-year sovereign bond issue was a significant milestone for our country. In difficult international circumstances, the bond was oversubscribed by as much as seven times, demonstrating very strong interest and investor confidence in our economy and the Government's fiscal and financial management. Strategically, the country's first ever bond issue coincided with the enormous boost to our global profile that has come from the investment we have made in hosting the APEC Leaders' Summit.

Other achievements in 2018 included the mobilisation of non-tax revenue through the enactment of the *Public Monies Management Regularisation (PMMR) Act 2017* which resulted in the transfer of significant funds to the Consolidated Revenue Fund to support the Government's budget.

Mr. Speaker, as we look to 2019 and beyond, this year has shown how substantial progress can be made even in the face of adversity. The progress highlighted above demonstrates that the O'Neill-Abel Government's approach towards implementing the *Alotau Accord II* has balanced the level of ambition against the need for fiscal responsibility, by ensuring we spend wisely and within our means. Critically, our strategies seek to ultimately get the country to a position where we can fully fund our recurrent costs, significantly expand our capital budgets and generate savings for future generations through a Sovereign Wealth Fund.

Mr. Speaker, the historic APEC event is culminating this week with the Economic Leaders Meeting, chaired by our Prime Minister. The Chinese President is visiting us for two days. Our Pacific leaders will be here as well. This is an unprecedented moment for our country to gain visibility and create trade and investment opportunities because that is what APEC is all about. It has also brought us legacy infrastructure, training and confidence to host other events in the future in the same manner as the Pacific Games did. APEC will resonate through the 2018, 2019 budgets and beyond.

With those introductory remarks, Mr. Speaker, I will now update the House on the state of the economy before discussing the 2018 Supplementary Budget and the coming year's Budget – the 2019 Budget.

STATE OF THE ECONOMY

Mr Speaker, the global economy is enduring new challenges especially with international relations becoming more delicate in 2018 predominantly due to trade tensions between some of our larger friends. This has affected our key commodity prices and the volatility has added to risk. The global economy is still projected to grow, in real terms, at 3.7 per cent in 2019 - not much lower than previously - but risks are tending to mount and this is affecting emerging market economies such as us.

Prices of PNG's major commodity exports are expected to be mixed in 2019 reflecting global economic and market-specific conditions. Oil, gas and palm oil prices are projected to average around same levels as 2018, while copper, gold, coffee, cocoa and copra oil prices are expected to be slightly lower.

Mr Speaker, in terms of domestic economic growth, in 2018, the economy is expected to grow at 0.3 per cent, lower than the 1.0 per cent projected at MYEFO and the 2.4 per cent projected at the time of the 2018 Budget. Whilst in 2018, the agriculture, forestry and fishery sector is expected to expand by 3.3 per cent in real terms, oil and gas sector production is expected to contract by 9.4 per cent predominantly due to the negative impact of the earthquake in February 2018 and the subsequent shut down for 7 weeks. Despite the quick re-start of production soon after and at rates above pre-earthquake levels, the impact was somewhat deeper than expected. Revenues though have been positively impacted due to above budget oil and gas prices and more vigilance in monitoring and pursuing related taxation and dividend flows.

The APEC event has provided a stimulus to the domestic economy however there also continues to be adverse effects of fiscal tightness, government arrears and the shortage of foreign exchange.

Mr. Speaker, creating quality jobs for our people remains a priority for our Government. The Bank of Papua New Guineas' total employment numbers appear to show signs of a gradual recovery in 2018, with the index increasing by 1.6 per cent over the year to mid-2018.

We believe the measures taken in the 2017 Supplementary Budget and the 2018 Budget to encourage import substitution, support local manufacturing and to provide a level playing field for domestic industry impacted by foreign market subsidies had a quick impact on local investment and employment in the value added sectors. This year local manufacturers commenced more than one billion kina in capital investment and expansion, and reported increases in output between 10 and 30 per cent.

Changes in the application of subsidies for the fishing sector has seen significant increases in domestic production, with the largest operators having added an additional shift (equivalent to more than 15,000 additional paid hours per week).

Mr. Speaker, advice from the manufacturing sector is that they anticipate employment growth of 15 per cent in 2018 with further growth in 2019-20 and this will also drive investment and employment growth in the service sector. This shows our Government's' policies are working and this employment growth in domestic value-added industries and local manufacturing are the early results of our plan to build a broad based economy, and more importantly this growth has not been confined to the large multinationals operating in PNG with small, medium and large local manufacturers also investing and expanding.

In the 2019 Budget, a number of measures have been announced that will accelerate broad-based private sector investment, activity and formal employment levels particularly in the non-mining sector.

Mr. Speaker, these comprise: the Government's policy to solve the foreign exchange imbalance; its plan to make substantial inroads into the arrears outstanding; the substantial adjustments to tariffs and excises which will further assist our manufacturing sector; the domestic debt retirement program that should improve the prospects for private sector credit; the pro-development infrastructure program including the SOE reforms planned; the full execution of the operational and capital budgets from the beginning of the fiscal year given the securing of financing; the kick starting of the large mining and petroleum projects in 2019; and the expected positive announcements from the APEC Summit, particularly in terms of direct support for PNG infrastructure development.

Mr Speaker, inflation in 2018 is now projected at 5.6 per cent, lower than the 5.9 per cent projected in the MYEFO and the 6.9 per cent in the 2018 Budget. The downward revision is due to lower quarterly outcomes of the consumer price index reported by the National Statistics Office and lower import inflation from our major trading partner, Australia. The upward pressure on general prices from the depreciation in Kina against the US Dollar, rising oil prices and increased import tariffs on certain food and beverages announced in the 2018 Budget had only a modest effect.

Mr. Speaker, let me now turn to our expectations for the coming year.

In 2019 the PNG economy is expected to pick up, reaching a real GDP growth rate of 4.0 per cent. This reflects more buoyant domestic conditions fueled by the recovery in the oil and gas sector and by the early works and services from large new mining and petroleum projects. It also reflects the positive impetus expected from the 2018 Budget where the foreign exchange imbalance is expected to be largely extinguished, where significant arrears payments are programmed to be made, and where the operational and capital budgets are expected to be executed as scheduled in 2019, given the securing of the budget’s financing requirements, and the revenue targets being met.

Mr Speaker, the medium term outlook for PNG is now much more optimistic than earlier estimates. Between 2018 and 2024, the economy is expected to grow at an average annual compound rate of 5.0 per cent buoyed by the new projects in both the mining and petroleum sector and the non-resource sector.

Mr. Speaker, the cost of basic goods and services which Papua New Guineans rely on is expected to continue to increase at a moderate rate of 5.4 per cent in 2019. To provide some relief to our people from the price pressures, the 2019 Budget will reduce the tax threshold for low to lower and middle income earners, while the recent appreciation of the Kina against the Australian Dollar should see some easing in prices of goods and services from Australia.

2018 SUPPLEMENTARY BUDGET

Mr. Speaker and Honorable Members, having in mind the update on the state of the economy, I would like to introduce the 2018 Supplementary Budget and explain why it has been necessary.

The 2018 Budget was the first Budget in the new Medium Term Fiscal Strategy 2018-22, which sought to address a number of long-running fiscal challenges. The Government made strong fiscal and financing commitments in 2018 that fiscal discipline was to be maintained such that fiscal deficits would decline as a proportion of GDP over the term of the plan, resulting in the debt to GDP ratio declining to 30 per cent by 2022.

This was to be achieved, Mr Speaker, through lifting revenue trends and pulling back expenditure trends. Importantly, within this declining expenditure trend, there was to be a compositional shift between rising operational spending and towards more development spending and at a decentralised level. And to solve the intractable financing and exchange rate constraints, a coherent and well-designed Medium Term Debt Strategy 2018-22 was formulated that would seek to fund the fiscal deficits and fix the exchange rate imbalance through a significant shift in the mix of financing toward external loans. And this was to be achieved without adding significant debt service costs to the fiscal program.

Overall, Mr Speaker, in 2018, substantial progress was made in achieving the ambitious goals and targets presented in the three medium term plans covering fiscal, revenue and debt strategies. The Government was able to fund its expenditure priorities and, although the expenditure level is expected to be above the budgeted level, increased revenue mobilisation has meant that the fiscal deficit in 2018, at K1, 897.2 million, is expected to be lower than programmed in the 2018 Budget. With nominal GDP rising more than budget, this has meant that the debt to GDP ratio is likely to end the year at 30.9 per cent, well within the target 30-35 per cent band and well on the way to achieving the 30 per cent FRA target by 2022.

Mr Speaker, our ambitious financing plans have subjected our economic management to intense scrutiny from the likes of the Asian Development Bank, the

World Bank, International Banking Syndicates and the Global Financial Markets. We have also worked more closely with the International Monetary Fund. This has helped us understand our own economy better, refine our strategy and present PNG to the world in a positive light.

The injection of international financing from the sovereign bond issue has been coupled with breakthrough access to direct budget support through facilities provided for the first time by the Asian Development Bank (USD300 million over 3 years), and for the first time in nearly 20 years by the World Bank (USD300 million over 3 years). Additionally, the Government is in discussions with a large commercial bank for a further low-cost budget support loan of USD300 million to support the 2019 Budget.

These new external financing facilities, Mr speaker, exemplify the growing confidence in, and respect for, our current approach to fiscal discipline, and the robustness of our systems. These have been successfully tested through the acute international scrutiny that came through engaging in these processes and programs. We welcome such tests as they not only highlight the advances that have been made in recent years, but also serve to ensure we are continually improving. As we deepen our relationships with our multilateral and bilateral partners in this way, we will be better placed to fully align these partnerships to our national vision and priorities.

Importantly, Mr Speaker, the proceeds from these external financing streams will be used to help fund the commitments of the 2018 budget and the financing requirements of the 2019 operational and development budgets, break the reliance on expensive, short term domestic debt, take pressure off domestic interest rates, and extinguish the foreign exchange imbalance.

Already, the 2018 drawdowns have helped ease the delay in fulfilling orders for foreign exchange, but we will not rest until balance is restored so our businesses can trade and invest without hindrance and unnecessary risk.

Mr Speaker, the dominant forces impacting the expected 2018 outturns have been a significant increase in mining and petroleum taxes and dividends on the one hand and, on the other, significant pressures coming from rising Government payroll costs which, to be frank, we have struggled to control. Mr Speaker, during the past 4 years there has been an escalating trend in a number of agencies exceeding their PE ceilings by significant margins.

Mr Speaker, several issues have contributed to the successive blowouts. There has been some under-budgeting reflecting industrial awards and superannuation benefits that the Government had not budgeted for. There was a lack of control in the system in terms of funds checking against warrants, and there was little control over the intake from Teachers, Health Workers, Police and Defence. The Government has sought to gain greater control by forcing some savings through recruitment freezes, agency amalgamations, agency abolishment, staff right-sizing, but these have not materialised to the extent expected. New measures have been announced in this 2019 Budget to regain control over this important expenditure category.

Mr Speaker, to maintain overall fiscal control, the Government has issued instructions to tighten up expenditures over the remaining 2 months of 2018 and allow unused warrants to lapse, and we will engineer a hard close to the accounts at year end.

Mr Speaker, the expected 2018 fiscal deficit (estimated at K1, 897.2 million, being 2.3 per cent of GDP) is lower than anticipated, with the debt to GDP ratio now expected to end the year at 30.9 per cent. This is well within the 30.0 to 35.0 per cent range prescribed by the *Fiscal Responsibility Act (Amended 2017)*, and the 25PP and FRA target of being capped at 30.0 per cent by 2022.

Mr Speaker, the improvement in revenue performance since 2016 has been significant. The reforms under the Medium Term Revenue Strategy 2018-2022 underpinning this turnaround will continue. Non grant revenue for 2018 is expected to exceed what was forecast in the budget and come in at K2.603 billion above the outturn for 2016. The revised estimate for total revenue and grants for

2018 is K13, 400.3 million against the budget estimate of K12, 731 million, which represents approximately 15.0 per cent of GDP - up from 13.0 per cent in 2016. Importantly the revenue increases are due to growth in both mineral and non-mineral receipts.

For 2018, Mr Speaker, despite the impacts of the earthquake, revenue targets are largely on track and we are projecting a net additional K671.0 million in revenue. This includes gains of K546.0 million from Mining and Petroleum Tax and K400.0 million from additional dividend payments from Kumul Petroleum Holding Limited for 2018, against some declines in other revenue heads.

However, Mr. Speaker, an increase in expenditure of K948.1 million is also expected, of which the unbudgeted increase in Personnel Emoluments is estimated to be K400 million which includes the unbudgeted payment of the 3.0 per cent pay rise granted to our public servants for 2017 and 2018, K146.1 million in additional to budget Nambawan Super Limited (NSL) exit payment arrears - which brings us back up to date with our current obligations. The above budget increase in goods and services is estimated to be K310.0 million which includes provision for additional arrears payments for Works, Medicine, Utilities, Rental and others. There is also an increase sought for interest payments of K72 million and for TFF for K20 million.

These increases are expected to be offset by reductions in the PNG Government funded capital budget of K277 million and the gain in revenue of K671 million.

Consequently, despite the expected decline in the fiscal deficit, a Supplementary Budget will still need to be submitted to cater for the over expenditures in these particular categories. The Supplementary Bill is provided in the attached documents. The total expenditure increase of K948.1 million will be funded by the projected revenue increase of K671.0 million and the expenditure savings of K277.0 million from the reallocation of capital from the PIP budget, thereby maintaining the 2018 Budget Deficit fiscal anchor.

Therefore, Mr Speaker, despite the more than offsetting increase in revenue in 2018 which resulted in a lower fiscal deficit of K90.0 million, these higher respective expenditures and reductions to capital expenditures will require a Supplementary Budget.

Mr. Speaker and Honourable Members, a Supplementary Budget for the 2018 fiscal year is required and will accompany the 2019 Budget.

2019 BUDGET

Mr. Speaker, I now present the 2019 Budget, with a fitting theme of ***"Building A Broader Based Economy"*** as we aspire to continue the momentum of 2018.

Mr. Speaker, as I have noted, the 2019 Budget is framed against a moderately strengthening world economic environment with a reasonable commodity price outlook, but with a more positive outlook for the PNG economy now projected to reach a real GDP growth rate of 4.0 per cent.

Mr. Speaker, 2019 will mark the second year for implementation of the Medium Term Revenue Strategy (MTRS). And we plan to continue to lift revenue trends – excluding grants – to 15.0 percent of GDP in 2019, and to lower the expenditure trends from the 18.6 percent in 2018 to 18.2 percent in 2019 and to just under 16 percent by 2022 - 23. This will result in maintaining the declining fiscal deficit to GDP trend and ensure we maintain our 30 per cent debt to GDP target and below.

REVENUE 2019

Mr. Speaker, the 2019 Total Revenue and Grants is projected at K14,266.8 million, an increase of K866.5 million (or 6.5 per cent) compared to the estimated 2018 outturns. This projection comprises K10, 784.5 million in Tax Revenue and K2, 539.2 million in Other Revenue and K943.1 million in Donor Grants. Tax revenue is expected to increase by K465.5 million, while non-tax revenue is expected to be K482.5 million higher than the estimated 2018 outturns.

Revenues from major tax heads are projected to increase above 2018 levels, except for Personal Income Tax which is projected to be lower. Company Income Tax is projected to reach K2.5 billion, Mining & Petroleum Tax K856.0 million, Dividend Withholding Tax K149.0 million, Interest Withholding Tax K116 million, Gaming Machine Tax K197.0 million, GST is expected to reach K2.2 billion, Excise Duty K923.0 million, Export Tax K405.0 million, Import Duty K358.0 million and Import Excise K322.0 million.

The lower Personal Income Tax projection of K2.9 billion reflects the Government's policy to lower the effective tax on low income earners by lifting the two lowest thresholds, being the tax free threshold from K10, 000 to K12, 500 and the 22 percent tax threshold from K18, 000 to K20, 000.

Mr. Speaker, Non-Tax Revenues are expected to remain high in 2019 and above the 2018 levels by K119.9 million. This is comprised of K1, 205.0 million in Dividends from State Owned Enterprises (SOEs), K750.6 million in Statutory Transfers from Statutory Authorities and K156.0 million in Fees & Charges.

The SOE dividends are expected to increase, with the bulk of the contribution being from Kumul Petroleum Limited (KPHL). One of the measures to strengthen non-tax revenues in 2019 is the implementation of the Dividend Policy of which mining and petroleum State Owned Enterprises will be required to pay a minimum of 50 per cent of their net profit after tax as dividend to the Consolidated Revenue Fund (CRF).

In line with the Dividend Policy, Kumul Petroleum Limited is expected to pay K800.0 million in 2019 which reflects an oil price at USD67.7 per barrel, and a normal year's gas production. Ok Tedi Mining Limited is expected to pay K200.0 million. Kumul Consolidated Holdings Limited and Motor Vehicle Insurance Limited are expected to pay K80.0 million and K25.0 million, respectively, and the Bank of Papua New Guinea is expected to pay K100.0 million.

In addition, revenues from the other statutory bodies through fees and charges and license fees are expected to increase, with bulk from the National Fisheries Authority. With the implementation of the PMMR, the sweeping of excess cash balances from respective trust accounts and operating accounts of the statutory agencies was completed in 2018. It is estimated that up to K750.6 million is expected from this revenue stream for 2019, and the amount is expected to settle around this level over the medium term.

Mr Speaker, revenues from departmental fees and charges are also expected to increase, of which K58 million is expected from the Department of Labour and Industry, K52 million from the Department of Lands and K46 million from other departments.

Mr. Speaker, I wish to bring to the attention of the House that collection of land rentals by the Department of Lands has been very weak over the past years, including this year with significant outstanding arrears to be collected as a result of the problems in the LAGIS system. In the 2019 Budget, the Department of Lands has been allocated a total of K4.7 million to address this problem and lift revenues from land rentals.

Mr. Speaker, our development partners will support us with a total grant of K943.1 million. We must note that donor grants are subjected to movements in exchange rates and policies of donors. We continue to receive major grant support from Australia through DFAT. Next year, they are supporting us with a total aid in grant of K711.0 million.

Mr. Speaker, it is also worth noting that our development partners have been very supportive in the hosting of APEC. This year, we have received grants in-kind of more than K100 million. There was also additional support for military exercises, training and capacity building to shore up security.

TAXATION MEASURES

Mr. Speaker, consistent with the Medium Term Revenue Strategy, the 2019 Budget introduces a number of new revenue policy measures. These measures support our efforts toward fiscal consolidation, as well as the need for continued investment in key expenditure priorities such as education, health, infrastructure, and law & order and to ensure the sustained delivery of essential goods and services.

Most importantly, the measures ensure an equitable burden is shared among our tax payers whilst raising sufficient revenue to ensure the Budget remains on track.
Mr. Speaker, I would like to inform the Honourable Members on the success of the tax policy amendments initiated in the 2017 Supplementary and 2018 Budgets. These tax policies have boosted tax revenues this year from the Mining and Petroleum Tax, Additional Profits Tax, Interest Withholding Tax and Gaming Machine Tax and will continue to deliver higher revenues in 2019.

Mr. Speaker, building on these successes, I now present to the Honorable Members the major revenue reforms and measures for the 2019 year:

1. Strengthening Revenue Raising Agencies

Mr. Speaker, the IRC and PNG Customs have started implementing administrative reforms consistent with the Medium Term Revenue Strategy in 2018. IRC launched the Large Tax Payers Office in September and has signed MOUs on tax collection assistance with provincial governments.

In 2019, Mr. Speaker, the Government focus is to continue to strengthen revenue administration at the IRC and Customs, through the establishment of the Program Management Office to oversee implementation of the MTRS programs, establishment of a designated Taxpayer Service Unit responsible for educational awareness on tax laws and the operationalisation of the Large Taxpayer Office. The strengthening of revenue administration has started to bear fruit, with the total number of taxpayer registrations 27 per cent higher in 2018, including a 14 per cent lift in company registrations. Customs will begin the implementation of the Customs Service Plan focusing on increase compliance and enhanced revenue collections.

2. Removal of GST zero rated status for Suppliers to Resource Companies

The GST zero rating status for companies which supply goods and services to resources companies will be removed. Under current practice, suppliers do not levy GST on supplies to resource companies but can claim GST refunds on inputs. This in itself is presenting administrative complexity for both the taxpayers (suppliers) and the IRC. This arrangement can disadvantage IRC if the supplier chooses to misreport the composition of goods supplied at the zero rate and goods supplied at the 10.0 per cent rate to non-resource companies, therein lifting the refund amount claimed for input credits.

This should not impact resource companies as they will then be able to claim a refund of GST paid on inputs.

This measure aims to address related fraud and to improve tax administration and is expected to raise K86 million in 2019.

3. Reform to Excise Tariff on Alcohol, Tobacco and Luxury Goods

Mr. Speaker, The indexation excise rate on alcohol has been suspended for 18 months meaning that excise rates will be maintained at the 1st June 2018 levels and after 18 months, the excise rates will be reduced to a 2.5 percent increase every six (6) months.

For tobacco, the indexation excise rate will be suspended commencing 1st December 2018, and thereafter, reduced to 2.5 percent increase every six (6) months. A second excise tier for tobacco has been established for local manufacturers of which there will be no indexation for one year. Tier two is only applicable to local manufacturers and the total allowable volume is capped to 50 percent of their tier one volumes in the prior year.

The local manufacturers have raised concerns on the falling demand for PNG made alcohol and tobacco products due to high prices caused by excise increases and stiff competition from imported substitutes that also involves cheap illicit products.

The Government through this measure intends to protect its revenue base by combating illicit trade and unregulated products and supporting local manufacturing.

These excise measures are expected to raise K70 million in 2019.

4. Introduction of an export tax on Sea Cucumber (Beche-de-mer)

The Government in the 2019 Budget will introduce an export tax of K15.0 per kg on sea cucumber exports to capture the resource rent on this endangered marine resource, assist National Fisheries Authority's efforts to curb overharvesting and ensure sustainable sea cucumber fishing. This measure is expected to raise K10 million in 2019.

5. Continued relief to domestic manufacturers

Mr. Speaker, this budget will continue to provide relief to our local manufacturers by introducing further amendments to the *Customs Tariff Act 1990*. These amendments include:

- increasing import duties for similar goods manufactured locally such as wooden furniture, shopping bags etc;
- split the flour tariff into retail and bulk and apply a zero rate to bulk imports and 25% to retail flour imports to encourage local value adding and local production of grain.
- address discrepancies in the tariff code, description and rates.

6. Moderate tax relief for low to lower-middle income earners

Finally, Mr. Speaker, the 2019 Budget introduces a moderate relief package to our low to lower-middle income earners. The Personal Income Tax relief package includes:

(1) an increase in the tax free threshold from K10,000 to K12,500; and
(2) an increase in the second tier 22% tax threshold from K18,000 to K20,000.

The Government through this measure delivers on one of its MTRS strategies to rebalance the PIT tax composition from income to consumption by relieving the tax burden on labour income.

EXPENDITURE 2019

Mr. Speaker, consistent with the Medium Term Expenditure Strategy, total expenditure as a percentage of GDP will be reduced to 18.2 per cent in 2019 then to 16.0 per cent per cent by 2022.

Given this comprehensive strategy, Mr Speaker, the 2019 Budget Expenditure envelope is set at K16,133.5 million. This comprises K10,636.4 million in operational expenditure and K5,497.1 million in capital expenditure. Compared to the 2018 Supplementary Budget appropriation, this budget envelope is projected to increase by K836.5 million (or 5.5 per cent).

In terms of key expenditure items, the Government will focus on adequately funding key programs covering Tuition Fee Free Education, Free Primary Health Care, Infrastructure Projects, Agriculture, Tourism and Small to Medium Enterprises.

Importantly, in the 2019 Budget, the O'Neill-Abel Government has reorientated the composition of expenditures substantially by re-prioritising and re-allocating spending from the less efficient expenditure areas to higher value priorities that would enhance overall economic growth and still achieve the strategic development goals of the Government. As a result, the Government is able to increase capital expenditures in the 2019 Budget by 19.3 per cent compared to the 2018 Supplementary Budget.

Mr Speaker, the Government in the 2019 Budget is providing, in many cases, substantial increases in sector allocations which include:

1) The Health Sector, which is central to human happiness and well-being. It also makes an important contribution to economic progress, as healthy populations live longer, are wiser and productive.

   A total of K1,553.1 million has been allocated to the Health Sector for the 2019 Budget which is 9.6 per cent of the total budget. The Health Sector has been increased by 3.1 per cent from the 2018 Budget. K249.8 million is allocated for medical supplies procurement and distribution processes. K100m is provided for District Hospitals.

2) The Education Sector plays the pivotal role in educating Papua New Guineans through the delivery of primary, secondary, Technical Vocational Educational Training (TVET) and tertiary education. These are facilitated through the National Department of Education, Department of Higher Education Research Science and Technology, colleges and universities.

   The Government will also continue to invest in infrastructure to accommodate the increasing number of students. Such programs include; Human Resource Development Phase II (K33.3 million), Secondary Schools Infrastructure Rehabilitation (K20.0 million), Western Pacific University (K30.0 million) and K20.0 million for Post Technical Educational Program (Gumine, Enga, Kokopo, Vanimo Polytechnic Institutions).

   A total of K1,378.2 million has been allocated to the Education Sector in 2019 which is 8.5 per cent of the total budget. The Education Sector has been increased by 6.6 per cent from the 2018 Budget. The Tuition Fee Free (TFF) policy is maintained while its funding has been increased from K602.0 million to K617.0 million. The amount excludes the teacher payroll.

3) The Transport Sector has been allocated K1, 287.4 million, making up 8.0 per cent of the total budget. The sector's budget is increased significantly by 37.4 per cent from its 2018 Budget.

   In 2019, the sector will focus on the following priorities such as: the Sustainable Highlands Highway Investment Program (K45m - K1bn over ten years), the National Highway Rehabilitation Program (K20.0 million); National Bridge Program (K10.0 million), Missing link Road Program (K17.0 million); Nadzab Airport Terminal Redevelopment Program (K75.0 million); New International Wharves in Wewak, Vanimo, Manus and Kikori (K8.0 million); Civil Aviation Development Investment Program (K90.0 million); and, Rehabilitation and Maintenance of Rural Airstrips (K10.0 million). A number of these major construction projects will be supported by the development partners through concessional loans. K100m is provided for the re-establishment of PTBs.

4) The Economic Sector is allocated K742.0 million, which is 4.6 per cent of the total budget. The sector's budget has increased by 11.4 percent from the 2018 Budget. This reflects the Government's commitment towards the growth of the Economic Sector. The increased funding is mainly towards ongoing activities with more emphasis on SME's, support of small holders' and growers' access to markets and participation, tourism development and onshore processing.

5) The Administration Sector will now host the Services Improvement Programs, in which we have sought to improve effectiveness and efficiency of SIPs. We have put in place a framework for the Service Improvement Program (SIP) Budget by allocating 30.0 per cent to infrastructure,

20.0 per cent to Education, 20.0 per cent to Health, 10.0 per cent to Law & Order, 10.0 per cent to Economic, and 10.0 per cent to the Administration sectors .These fixed commitments are complemented by other capital projects approved by the Government. Total expenditure for the sector consists of K2,042.4 million in operational expenditure which is inclusive of miscellaneous funding worth K1,320.9 million and K2,022.6 million in capital expenditure, inclusive of PSIP and DSIP (K1,080.0 million). Of the total budget for operational expenditure, K479.0 million is assigned for compensation of employees and K242.4 million is for goods and services;

6) The Renewable Sector has received funding for the New State Land Acquisition Program (K20.0 million), SMEs Funding for Agriculture and Non-Agricultural Activities (K100.0 million), State Equity Funds - Agriculture and others (K100 million), Strategic Defence Against Coffee Berry Borer(K10.0 million), Regional Cocoa Nurseries Program (K10.0 million) and (K22.0 million for Productive Partnership in Agriculture Program (PPAP).

7) Small business activities will be supported by the SME Access Risk Financing Facility (K4.4 million) and the National Development Bank (NDB) to facilitate SME Funding - Agriculture and Non Agriculture (K100 million).

8) The Tourism Sector will be supported through the implementation of the Tourism Sustainable Development Project (K50.0 million) by the Tourism Promotion Authority (TPA).

9) The total budget for the Provincial Sector in 2019 is K3,073 million which is 19.0 per cent of the total budget. This is comprised of K2,877.3 million in operational and K195.7 million in capital expenditures. Funding for SIPs (PSIP and DSIP) worth K1,080.0 million has been reallocated under DIRD’s budget (Administration Sector) with the province’s capital budget being commensurately reduced. Funding for DSG and WSIP are maintained in the

Provincial Sector.

2019 FINANCING & PUBLIC DEBT

Mr Speaker, a total of K1, 866.7 million will be raised in debt financing to support the funding of the 2019 Budget. Commensurate with the new MTDS 2018-22, this net borrowing will be financed in full through external sources totaling K2, 496.1 million of which K629.4 million is for domestic debt redemption.

The external financing for 2019 will be funded through the second tranches from the ADB and the World Bank budget support loans, commercial financing mostly drawings from the Sovereign Bond Trust Account and new concessional project loans. The Government is also considering extending its external debt portfolio further through the take-up of a budget support loan from the China Development Bank at favourable interest rates.

Mr Speaker, the 2019 planned net borrowing is expected to increase total Government debt to K27, 322.2 million by end-2019, which is equivalent to 30.8 per cent of GDP. By end 2019, total debt is projected to comprise of K15, 940.3 million or 18.0 per cent of GDP in domestic debt and K11, 381.8 million or 12.8 per cent in external debt.

Mr. Speaker, the projected net borrowing of K1, 866.7 million, is equivalent to 2.1 per cent of GDP, and translates into a debt-to-GDP ratio of 30.8 per cent which is within the 30-35 per cent boundaries prescribed in the *2017 Amended Fiscal Responsibility Act (FRA)*.

REFORMS

Mr. Speaker, reforming the Public Sector continues to be a high priority for the Government to improve the productivity and effectiveness of the public service and create an environment that is conducive for private sector expansion and growth.

The public sector reform agenda will focus on improving public finance management through the implementation of the recently approved PFMA. Going further, the Government over the medium term, starting in 2018 will promote value for money and efficiency through a number of reforms including:

- Improving the management of personnel emoluments, through the work of OSPEAC;
- Management of Manpower and Personnel Emoluments Ceilings;
- Industrial Pay Fixation Agreements;
- Reducing overlap by implementing the amalgamation program, and effectiveness through reforming procurement;
- Merging National Departments and Agencies; and
- Improving the selection of capital projects by creating the committee led by Planning evaluating the financial and economic impacts of each project.

The successes of the 2018 Budget have only been marred by some continued expenditure overruns related to rising government payroll costs. Instructions have been issued to tighten spending over the remaining months of 2018 to minimise this overrun, and we will redouble our efforts to control expenditure into the new fiscal year.

The Government's target is to keep Personnel Emoluments (PE) under 5.0 per cent of GDP in 2019 and over the medium term. Commencing on 1st January 2019, we intend to completely overhaul the payroll process with salaries and wages controlled by warrants and hard ceilings, just as is the case for the purchase of goods and services. Any agency that overspends on their payroll will have to find savings elsewhere in their budget. The procurement process to engage independent auditors to review the payroll system has commenced. A priority will be to establish correct manpower data to assess staff on strength and intake into the services will be evaluated and budgeted correctly. This has been difficult in some areas, such as for

Teachers, Health Workers, Police and Defence where there are large movements of personnel, including intake and retirement, and so special efforts will made to ensure that persons in these sectors are fully accounted for and the correct numbers are uploaded into the personnel management systems.

In fact Mr Speaker, we have taken on 4,843 new public servants this year to date, 1,681 teachers, 1,458 health workers, 1,440 in the disciplined forces and 693 in the IRC and Customs. This brings to total number of public servants to 124,048.

Mr Speaker, by the end of 2018, all of the commodities' boards should be properly constituted and functional. This Government is committed to the ongoing strengthening of governance, especially as it relates to increasing the transparency and effective management of public monies.

In 2019 some of the large infrastructure projects that have been initiated under the 25PP will come online, including the international submarine cable and domestic broadband cable that will vastly improve connectivity and reduce costs. Progress will continue on the other key national infrastructure programs, including the Highlands Highway, the Port Moresby and Lae Ports and provincial ports' upgrades, the missing link roads program, hydro and gas power generation, and the airport terminal and runway upgrade. These are vital transformational projects that will reduce costs for businesses and consumers, improve market access for rural farmers, and promote the further expansion of the private sector.

Mr. Speaker, on the back of the APEC event, PNG will continue to embark on a number of structural reforms, as the Government will continue to partner with key stakeholders in removing barriers to doing business and investment in PNG in specific sectors such as aviation, communications and SMEs. Central to this set of reforms are the recommendations captured in the Consumer and Competition Framework Review and the Financial Services Sector Review which have been endorsed by the Government and will be implemented in 2019. Also, the Department of Treasury and BPNG are focusing their efforts on improving access to finance through microfinance, SMEs financial and greater financing inclusion programs.

ECONOMIC AND FISCAL RISKS

Mr. Speaker, although the global economy is anticipated to stabilise in 2019, uncertainty in global trade relations between the US and China continues to pose volatility risk that could impact adversely on commodity prices and our exports in the agriculture, fishery and forestry sector, and mining and quarrying and oil/gas sectors, leading to exchange rate pressures and higher interest rates on external debt.

The earthquake that shook part of the Highlands Region, with associated social, fiscal and economic implications is yet another observation on how natural disasters remain considerable risks to our plans going forward.

Mr. Speaker, a number of fiscal risks continue to be present and have become more critical over recent years including:

- delays in early works on some of the major mining and petroleum resource projects will adversely impact GDP growth;
- failure to lift revenue collections and failure to implement reform plans in particular on non-tax revenue will adversely affect the 2019 Budget and the medium term;
- failure to fully control personal emoluments spending will prevent the expected fiscal space needed to support efficient public investment;
- failure to reduce arrears significantly will undermine business confidence and investment;
- management of foreign exchange liquidity and foreign exchange risks.

Finally, Mr. Speaker, failure to obtain the budget support loans in 2019 will lead to an external financing gap that will undermine budget implementation.

Nevertheless, Mr Speaker, the Government remains committed to its Medium Term Fiscal Strategy and will take the necessary mitigation strategies should any significant risks materialise.

We remain confident that our Medium Term Debt Strategy with a renewed focus on external financing will provide the necessary liquidity to mitigate many of these risks, at least until the healthy balances in the SWF are accumulated.

CONCLUSION

Mr Speaker, overall, 2018 has been a remarkable year given the earthquake in particular. We have been able to meet the challenges which includes staging APEC admirably. I repeat that we need to remain focused particularly on the basics of revenue generation, expenditure control and debt management to build on the great progress being made.

As we wind up APEC activities and bid farewell to our international guests, we not only retain the substantial infrastructure improvements built for this historic event and the bolstered trade and economic relationships, we also take away the rejuvenated sense of pride and resilience that have underscored the national spirit this year. If we continue to harness this spirit, together we can continue to build a better future for our country.

The 2019 Budget is a holistic framework to fix lingering issues from our past, serve the needs of today, and set the foundations for **"Building A Broader Economic Base"**.

I want to thank the Prime Minister (and wish him well as he represents us in the coming Leaders Summit), the Ministers for Finance and Planning and their hardworking staff, the Secretary for Treasury and his staff, Cabinet and the Ministerial Economic Committee and all the members of this House for your understanding and support.

I commend the 2019 Budget to the Honourable Members and to the people of Papua New Guinea.

HON. CHARLES ABEL, MP
DEPUTY PRIME MINISTER AND MINISTER FOR TREASURY