



**Treasurers Statement
"January to May 2019 – Fiscal Position"**

26 June 2019

Mr. Speaker

On behalf of my family, my District of Bulolo and my fellow Morobeans, let me say that it is an absolute privilege to address this honourable house as the Minister for Treasury in the Marape-Steven Government in this 10th Parliament. I humbly commend the Prime Minister for entrusting me with the opportunity to lead in this Ministry.

Our good Prime Minister Honourable James Marape has broadly outlined the direction of the Government going forward in his recent State of the Nation address.

My job today is to review the State of the Economy as it is now – just a few weeks before the Mid-Year Economic and Fiscal Outlook (MYEFO) is published and released; highlight the consultations and discussions going on; and outline the immediate actions that are required as well as flag changes that need to be considered going forward that may over-flow into the 2020 Budget Strategy.

In the MYEFO Report we will look at the broader policy issues affecting the economy and the Government will have had more time to have sectoral input into the discussion.

The Prime Minister has stated, that going forward, bringing stability, growth and confidence in our economy is – and must be – our major focus.

That context must not be lost – but integrated – into the “Take PNG Back” and make it “The Richest Black Christian Nation on Earth”.

Let me assure you all: Over the coming days, weeks and months this Government will continue its process of consultation, of communication, of designing and restructuring the policy agenda.

This Government was ushered in on the prayers of transparency and inclusiveness. And that is a process that the Marape-Steven Government, with me as Treasurer are committed to.

I have started these consultations with the public sector to ascertain and confirm what are those processes which make us slow, inefficient and costly;

I have commenced discussions with colleague Ministers on how to make State Owned Enterprises (SOEs) become drivers of economic development and how institutional investors in country can be involved including Nambawan Super, Nasfund and Comrade Trustees;

I have commenced dialogue with our private sector to see how we can kick-start innovation, investment and drive;

I have engaged with our multi-lateral and bi-lateral partners to confirm where they fit into our national agenda; and

I am in full discussion with our financial community to ensure that our market is stable, developing and inclusive.

Mr. Speaker

To be more transparent and inclusive with the formulation and administration of the National Budget process, the Fiscal Responsibility Act 2006 requires the presentation of a Final Budget Outcome (FBO) within three months of the end of the Fiscal Year.

This, of course, is then followed at this time of the year, with the handing down of the Department of Treasury Mid-Year Economic & Fiscal Outlook - which effectively gives us our annual half time score on the economy.

This however takes greater significance right now in light of the change in Government last month. Whilst we are awaiting our end of June results and there may be some variations, I do not expect that the general trends will change too much.

We will consider the best way to address any changes to the 2019 Budget framework within the next few months or a major re-orientation in the 2020 Budget.

Let me first start off with issues related to our **Economic Activity**.

The impact of the earthquake in the first half of 2018 had a substantial social and economic impact on the economy in 2018.

The country's growth forecasts were downgraded, with our own early internal assessments pointing to a significant slowing down of the economy and external assessments led by the IMF suggesting a very sharp contraction in GDP growth.

However, after an eight-week shutdown, our mineral and gas production was able to restart earlier than expected at rates of production above the pre-earthquake levels. This is the value of having world class partners.

Advice at the time from the mining and gas sector on production rates for the full year led Treasury to estimate that real GDP would be lowered to 0.3 per cent in 2018.

This is important as how we end 2018, sets the foundation for how we commenced 2019.

Mr. Speaker

Following the first round forecasting exercise done independently by Treasury, this real growth rate, unfortunately, has now been further lowered to negative 0.7 per cent.

This is due to lower than expected LNG and condensate production in the second half of 2018 which fell from record levels in 2017 of 447 British Thermal Units of LNG and 11.9 million barrels of condensate to 382 British Thermal Units for LNG and 9 million barrels for condensate in 2018.

This is significantly lower than the earlier estimates provided by Exxon Mobil after the earthquake which were factored into the design of the 2019 Budget.

The assumption in the 2019 Budget was that oil & gas sector would fall by 9.4 per cent in 2018, however we now know that it actually fell by 16.4 per cent.

Importantly, the first round forecasts have revised the output from the agriculture, forestry and fishing sector up to 3.7 per cent real growth from 3.3 per cent in the 2019 Budget due to better than expected palm oil and log production.

The mining and quarrying sector is also now expected to increase in real terms by 2.9 per cent, up from the 0.2 per cent in the 2019 Budget and that is being driven by an increase in gold and nickel production.

The real potential for broad-based growth for PNG is in this renewable sector of the economy comprising agriculture, forestry, fisheries, tourism and manufacturing. I want to flag that the 2020 Budget strategy will be re-oriented towards these sectors.

Nevertheless, these improvements in the renewable sector have not nearly been enough to compensate for the fall in oil and gas sector production in 2018.

Clearly the earthquake had a larger adverse impact than was assumed in 2018. And with a continuation of passive domestic business conditions over 2018 provides us the major reasons why domestic economic conditions and employment growth remained relatively low.

This is the case even when we take into account the lift from APEC spending and the improvement in foreign exchange imbalances at the back end of 2018.

There is, however, a positive effect from the fall in production of LNG and condensate in 2018. It is expected that 2019 production levels will rebound to full production, resulting in strong growth in the oil and gas sector by an expected 13 per cent in real terms in 2019.

This is now expected to lift real economic growth in 2019 to a solid 4.8 per cent which is above the 4.0 per cent forecast in the 2019 budget.

Mr. Speaker

Regarding living standards as measured by per capita real GDP growth, between 2012 and 2018, real GDP increased at an average annual compound rate of 6.3 per cent and a per capita average annual rate of 2.7 per cent.

Real output per person has improved over this period and this was despite the severe drought, commodity price shocks and the earthquake of recent years.

But it is recognised that real GDP per capita has been sluggish in recent years and that our people are hurting because this real GDP growth has not happened where most of our people live.

Therefore, while the growth forecasts are expected to pick up in 2019 and beyond, as the gas and mining projects come on line, a much higher growth rate is required if the living standards of the population are to be improved substantially.

We must pursue higher growth rates if we are to reach the target set by our Prime Minister to become the Richest Black Christian Country on Earth.

Importantly, this Government's policies will focus on the targeted areas of agriculture, fisheries, forestry, tourism, manufacturing and the small to medium enterprises sector so that economic growth is broad-based and more meaningful for ordinary Papua New Guineans throughout the country.

Mr. Speaker

It is my intention to be blunt and transparent with the current state of the economy and so let me now update this Honourable House with the Government's fiscal position for the first five months of 2019.

Based on May data, net borrowing or the budget deficit as percentage of GDP was 1.6 per cent. This is higher than expected due to lower revenue collections from IRC, lower dividends from SOEs and lower departmental fees and charges.

Lower expenditure on both the Goods and Services budget and the Capital over the first 5 months has partly, but not sufficiently offset the fall in revenue, resulting in a higher than expected deficit.

The fiscal deficit and debt levels as a share of GDP have also been adversely affected by the downward revision to nominal GDP levels. As at end May 2019 the debt stock as a share of GDP was 31.4 per cent, which is slightly above the budget target of 30.8 per cent.

It should also be noted that, over the first 5 months, of the required financing for the deficit of K1.3804 billion, only K321.2 million was added to the debt stock.

The remaining K1.0592 billion being financed from a drawdown in external borrowing trust balances at the end of 2018.

As these trust balances will not be available in the second half of 2019, further fiscal tightening will be required if a lift in revenues is not forthcoming and if the budget is to remain on track.

Whilst there are a lot of number here, the story is quite simple.

We are slightly behind on revenue largely because we haven't received dividends, the PMMR funds are also down and so are other fees and charges. Therefore, we have not been able to spend as much as we would have liked on both the Recurrent and Capital Budgets.

To cover this shortfall, we have had to dip into our accounts and borrow a little more from the domestic market because the planned external financing that we thought we would secure in March this year has not been finalized.

Mr. Speaker

Let me provide some details on the revenue picture over the first 5 months of this year.

In total, IRC collections are 8 per cent below budget expectations for the first five months to now. Customs' collections are 17 per cent above expectations, and non-tax revenues are significantly lower, resulting in total internal revenues being 19 per cent below expectations.

No amounts under donor grants have been recorded up to May in either revenue or expenditure data due to delays in reporting by donors. We will be asking donors to be submitting reports according to our reporting rime line as well so that we and they can be held accountable for these funds as well.

The decline of K974 million in the January to May revenue results is mainly due to the following adverse trends:

Lower dividends from State entities, the PMMR revenues and departmental fees and charges are responsible for over 60 per cent of the revenue shortfall.

Over the 5 months to May, only K100 million in dividends were received against a budget expectation of K502.1 million. K430 million was collected over the same period in 2018.

OTML paid K134.0 million as an overdue payment in February 2019 and, consequently, was written back into 2018.

The poor performance of dividend collections is a major concern and the Marape-Steven Government is intent on improving the performance of State Owned Enterprises both in terms of services to our people and in financial returns to the State.

The expected transfers from the PMMR process were only K150.8 million lower than budget expectations. Note also that this is lower than the corresponding period in 2018.

In 2018, the sweep exercise of sweeping the revenues from previous years held by Statutory Authorities in Interest Bearing Deposit accounts with the commercial banks was the driving factor behind the strong performance of PMMR numbers, however, this year, since those previous year-'s' balances have been swept, current transfers are now based on annual collections which is a lower amount.

The National Fisheries Authority (NFA) is the major contributor to PMMR revenues. They have stated that the rebate scheme - intended to encourage downstream processing of fishery products to create local job opportunities - is also affecting the performance of NFA's contribution to the budget.

PMMR transfers are likely to remain below budget in 2019. I have directed my Department to establish an improved projection of the annual revenue from these Statutory Authorities for budgeting purposes and address any policy shortfalls to improve underlying revenue flows.

Departmental Fees and Charges are, at this stage, lower by K46.7 million with land rental collections in particular remaining below budget. Systems have yet to be improved and so these low collections have continued into June.

Mr. Speaker

IRC tax collections are lower than we expected and lower than we would like.

GST paid into the Waigani Public Accounts is K62.8 million lower than expected over the first 5 months of 2019 due higher than anticipated GST refunds.

Simply, sometimes, if the IRC owes you a company a GST refund, it allows the recipient to just reduce the amount of Corporate Income Tax amount it owes to the IRC by that amount which obviously reduces the CIT overall.

GST exemptions on imports and lower transfers from the GST trust account were also the case after the substantial transfers in 2018.

We must also acknowledge that the passive local business conditions are reflected in lower imports and sales.

GST compliance issues remain a concern, but it is an area where the IRC can and must pick up.

Corporate Income Tax collections over the first 5 months of 2019 are one third lower than expected and 12.6 per cent lower than in the same period last year.

Government arrears and subdued business sales are all likely to be dampening profitability and income tax payments.

As with GST, Company Tax compliance issues also remain a concern.

Mining and Petroleum taxes (MPT) are 9.1 per cent lower than expected, but they are significantly higher than the earthquake affected collections at this time last year.

We need to note that these taxes from Mining and Petroleum continues to be volatile depending on commodity price cycles and natural disaster costs.

The higher use of infrastructure tax credits may also be responsible for lower tax collections so far in 2019.

Other direct tax receipts are slightly lower than we expected with lower stamp duties and interest withholding tax receipts partially offset by higher revenues from departure tax and gaming machine tax.

The policy changes of merging stamp duty into bookmakers' turnover tax and increasing the Bookmakers turn over tax rate to around 9.0 per cent may explain the decline in stamp duties.

Revenue from gaming machine tax has continued to benefit from the tax policy measure to increase the Government's share from 46.0 per cent to 55.0 per cent.

Higher dividend withholding tax collections may reflect the improvements in foreign exchange supply facilitating the offshore payment of dividends.

Mr. Speaker

In contrast, revenue collected by Customs has generally performed well against both expectations for the first 5 months of 2019 and against the corresponding period of the previous year.

Inland Excise is up K133.9 million on expectations partly reflecting the advance payment by British American Tobacco.

Import Duty is higher than budgeted by K31.7 million reflecting improvements to foreign exchange access, compliance efforts by Customs, and other tariff policy measures.

The above increases have been partially balanced by:

Lower export duty collections over the first 5 months which is contrary to projections when we consider the high average log prices in January, February and March but lower in April and May;

A new duty rate and policy measures to introduce an export tax on Sea Cucumbers - which has yet to be collected.

Excise on imports is also lower than budgeted perhaps reflecting the increase in diesel excise on imports.

This has led to some switching in market share of the local producer and away from imports, in addition to the restriction on vehicle imports to those manufactured after 2014.

Donor grant receipts are at this stage unaccounted for due to the delay in reporting of these in-kind receipts.

As I said earlier, it is my intention to require greater accountability and transparency from donors to report better to their own domestic tax payers as well as our local recipient population for whom aid monies have been intended.

Mr. Speaker

Let me start my report on Expenditure by first looking at the Operational elements.

Operational Expense (excluding debt service repayments) from January to May 2019 was K4,547.3 million, which is 3 per cent higher than expected but much lower than the total warrant of K4,996.8 million that Treasury had released.

This mainly reflects higher expenditure on the public sector wage bill, up 4.1 per cent and higher expenditure on the Goods and Services, which is up 2.4 per cent.

Personnel Emoluments remains our biggest cost issue. But it is not as simple as saying cut the size of the public service which was a point made very well by my predecessor and now Minister for Finance, Hon. Charles Abel.

I'll address some of these issues after I run through some numbers but suffice to say, it is a challenge, but we can address this and we will be better for it.

Expenditure on personnel emoluments from January to May totaled K1,795.2 million, with PE expenditure by national departments over by 7.3 per cent and teachers over by 11.0 per cent.

Offsetting the increased amount was a shortfall in the payment of Nambawan Supa Limited exit fees of K43.6 million which we owed already.

Unless additional controls and policy changes are implemented, PE expenditures will exceed the 2019 budget by a significant amount which predominately result from the base effects of:

- the 3 per cent pay increase paid in late 2018;
- additions to the teachers' payroll; and
- the 3 per cent incremental increase for 2019 which will include the back pay component.

The Organisational Structure & Personnel Emoluments Audit Committee continues to review the situation and an accurate assessment and policy response by this Government will be included in the 2019 MYEFO. In the interim, offline and overtime payments are being contained.

Mr. Speaker

Let me take us through the Goods and Services component of the Operational or Recurrent Budget.

Goods and services expense in May totaled K2,752.1 million, 2.4 per cent higher than budgeted.

However, national departments' goods and services spending was 6 per cent lower than expected, despite the issue of higher warrants, which was due to the lack of availability of cash.

The following expenditure categories were controlled:

- Other Operational expense totaled K344.1 million which is K89.1 million lower than the budgeted expense and K133.0 million lower than the warrant released;
- Education subsidies' expense totaled K210.0 million which is K49.0 million lower than budgeted and K45.2 million lower than the warrant released;
- Medical Supplies' expense totaled K67.4 million K37.8 million lower than budgeted and K1.1 million lower than the warrant released;
- Court Cases' expense totaled K5.3 million K5.6 million lower than budgeted and K2.5 million lower than the warrant released;
- Emergency Roads and Bridges' expense totaled K0.4 million which is K3.6 million lower than budgeted and K2.6 million lower than the warrant released;
- Provincial Health Authority Operations' expense totaled K40.9 million which is K6.6 million lower than budgeted and K9.5 million lower than the warrant released warrant released;
- Tertiary Education Study Assistance expense totaled K29 million which is K0.7 million lower than budgeted and K10 million lower than the warrant released; and
- Provincial Functional grants (including ABG) expense amounted to K108.1 million which is K113.5 million lower than budgeted and K48.2 million lower than the warrants released.

Mr. Speaker

In contrast, there were above budget expenditures compared with expectations mainly due to the adjustment that was made to 2018 commitments which were paid into 2019 and therefore using 2019 funds.

These expenses amounting to K280.9 million (excluding the DSIP adjustment), have had to be expensed against warrants in 2019 to comply with the Public Finance Management Act and the budgeted expenditure envelopes were reduced accordingly.

These expenses comprised:

- Rental expense totaling K141.7 million, of which K74.0 million represented the end 2018 adjustment. This is this situation where payments were made in November and December 2018, but they were not presented to the Banks until 2019. Because we now are using 2019 funds and 2019 warrants we have had to increase our rental expenditure in the January to May by K57.3 million against target but that keeps us still below the warrant released by K10.1 million.

Without the adjustment in rental expense, the first five months is well under budget although some additional arrears have accumulated;

- Utilities' expense totaled K93.1 million, of which K27.2 million was expensed through the end 2018 adjustment. Expenditure restraint resulted in an increased expense for the first five months by K42.7 million against target and is below warrant released by K1.0 million.

Without the adjustment, utilities' expense for the quarter is well under budget. Again some additional arrears have accumulated;

- Other 2018 Adjustments included the APEC arrears expenditure envelop for 2019 which had to be reduced by K6.7 million, National Airports Corporation capital expenditure was reduced by K12.0 million, Police Support Services logistics was reduced by K10.0 million and the National Disaster Centre expenditure was reduced by K10.0 million;
- Maintenance of Priority Roads expense totaled K65.7 million, of which K50.0 million was expended through the end 2018 adjustment. Expenditure restraint resulted in an increased expense for the first five months of K27.9 million against the January-May target and is below warrant released by K3.8 million.

Without the adjustment the road maintenance expense is well under budget for the first five months;

- Highlands Highway Roads Maintenance totaled K61.7 million, of which K50.0 million was expensed through the end 2018 adjustment. Expenditure restraint resulted in an increased expense for the first five months of only K27.5 million and is below warrant release by K2.9 million.

Without the adjustment the road maintenance expense is well under budget for the first five months; and

Other road expenditure was reduced by K40.0 million.

Mr. Speaker

Other above budget expenditures in the five months comprised:

- Foreign Mission expense totaling K15.6 million, higher by K4.7 million against the target expense, however, lower than the warrant released by K2.0 million;
- 2019 LLG Election Security and Logistics expended its full K13 million warrant up to May 2019;

There were no warrants released and expenses on Free Primary Health care up to end May;

- Transfers to Commercial and Statutory Authority expense amounted K326.2 million, up by K51.7 million against the budget.
- Interest payments and fees expense totaled K973.9 million, up by K142.7 million against the target expense. The rise in interest costs reflected large coupon payments on treasury bonds and interest on called guarantees.

Mr. Speaker

In relation to the Capital Expenditure component, from Jan-May 2019, expenditure on Development and Capital Investment was K1,120.9 million, K942.6 million below the budget target from warrant issuances of K1,208.2 million.

The decline was despite a K393.0 million increase to DSIP spending that was brought into 2019 from 2018 commitments in the adjustment which resulted in DSIP expenditure of K482 million to end May, above the target

expenditure by K108.2 million. Again, these are payments made in 2018 but not presented until 2018.

However, all other capital and development expenditures were well below both budgeted and warrant levels. The PSIP and DSIP expenditures in total amounted to K18.1 million, which is K101.4 million below the target expense amount reflecting the cash issues during this period.

Fixed commitment capital expenditure amounted to K362.7 million up to end May which is lower by K338.5 million against warrants issued and lower by K713.6 million against the target expense for the first 5 months.

Mr. Speaker

And Honourable Members of this House, the net financing requirement for the first 5 months of this year was K1,380.4 million.

This comprised of the fiscal adjustment amount of K1,059.0 million brought into 2019 from 2018 and K321.2 million in new net deficit spending over the first 5 months which is modestly lower than targeted in the 2019 budget.

The lower deficit spending (excluding the end year fiscal adjustment that was funded predominately from the external financing trust balances) reflected the serious cash constraints over the first 5 months.

The programmed USD300 million external financing by the China Development Bank did not eventuate in the first 5 months resulting in the need to, once again, enter the domestic debt market where K491.3 million in new treasury bills were raised.

As a consequence, the domestic debt redemption program has been suspended. The increased issuance of treasury bills has led to upward pressure on interest rates.

This has been made worse by the tight fiscal conditions that reduce liquidity in the system resulting in the banks failing to take up recent weekly offerings from the Governments auctions to raise cash.

Mr. Speaker, the shift in the Medium Term Debt Strategy to budget financing through external loans is an appropriate debt strategy given the challenges in raising domestic finance and the excess demands for foreign currency.

I need to make this point, we need to be substituting away from the expensive domestic market to the cheaper international markets and when we do so, it drives the price of borrowing down domestically as well.

The failure to secure the promised CDB loan at APEC has hindered financial management over the first 5 months.

The previous Government in early May approved a number of financing options.

This includes an additional sovereign bond issuance and/or a further loan from Credit Suisse. We are now looking at these options and will make some announcements soon.

Mr. Speaker

This is an honest assessment of the major fiscal issues we are facing.

Now the question is what are we going to do about this?

My job and the challenge for this Government is to ensure that fiscal policies and economic management with respect to both the resource sector and the non-resource sector are improved.

Right now I intend to formulate and establish a credible macroeconomic and fiscal framework as the foundation for stronger economic growth in accordance with the vision that the Prime Minister has laid out.

This is required because we have to:

- keep our budget deficit and public debt under control,
- provide for the lowest cost financing taking into account the risks involved,
- keep inflation low because high inflation erodes our people's standard of living faster than anything else,
- keep our exchange rate relatively stable and competitive to lift business confidence,
- maintain healthy levels of international reserves, and
- maintain low country risk premiums so that our foreign partners and investors look to PNG to invest much-needed capital.

Then we will need to overlay our specific policies, services and projects into this framework to:

- create productivity and economic activity,
- plug governance leakages and cut wastage, and
- give our people the best chance of unleashing their energies and outputs and achieving the higher incomes and standards of living that they deserve.

The previous Government of which I was a part, designed a comprehensive fiscal and financing program embodied in the Medium Term Fiscal Strategy 2018-22 and legislated into the Fiscal Responsibility Act targets.

This framework has been designed in partnership with the IMF and World Bank and has been accepted by the International Financial Institutions and the International Financial Markets.

The success of World Bank Budget Support, the ADB Budget Support and the Inaugural Sovereign Bond are evidence of success of this which we should be proud of.

The ratings agencies have highlighted the credibility of the framework and it was interwoven into the 2018 and 2019 national budgets which aimed to:

- 1) lift government revenues,
- 2) contain non-essential spending, and
- 3) divert spending to the Government's social and economic project priorities particularly in health, education and the district and provincial services improvement programs.

It was to be predominately financed through a shift in financing from the unreliable and expensive domestic sector to the external sector through the issuance of sovereign bonds and through budget-support partnerships with the World Bank and Asian Development Bank.

The aim of the external financing strategy was to:

- a) fund the budget on time, allowing effective budget execution,
- b) extinguish the increasing foreign exchange imbalance, and
- c) lower domestic interest costs because we are more and more using the international debt markets.

This robust framework has achieved much for us despite a challenging international economic landscape.

The budget deficits were contained in 2017 and 2018, revenue was increased in 2018, and key programs such as Tuition Fee Free education, were achieved.

However, as noted in the report on the 5 months to May, there have been a number of problems that have worsened.

If these continue, we could miss our targets in this framework and find ourselves well off track which will result in a loss of credibility in PNG's economic management.

There are some policy issues that we need to deal with and the first one is the revisions to the GDP data for 2014-16 done by the National Statistics Office using a new methodology with the support of an Australian advisor.

These revisions have tended to lower our nominal GDP growth rates for those years and, consequently, adversely affected our fiscal framework targets.

This is not a performance issue, not an implementation issue or even a technical issue. This new method requires improved and accurate data and so when I consider the quality of the data available in our country, we run the risk of chasing a very high level of precision, but achieving a very low level of accuracy.

I am tasking both the NSO and Treasury to re-examine these issues while I will also commission an independent review to resolve this issue as it is vital in our policy making alignment to correct and internationally acceptable norms.

Technical arguments aside, what is important for the Marape-Steven Government is for us to grow real GDP from the current K65 billion to the K100 plus billion mark by 2025 in order to give this country a better deal from a larger cake.

The second issue is the issue around the Fiscal Year. There already exists policy discussions and policy decisions on moving from a January to December fiscal year to a July to June fiscal year.

This will deal with the end of the year rush and the slow start to the beginning of the year. These issues always undermine budget performance and so I intend to modernize this just like the rest of the world has already done.

Mr. Speaker

Just to recap, there are a number of concerns over revenue trends -

Collections of Corporate Income Tax and GST to the Government have been below target and continue to be confronted with challenges of compliance and very subdued domestic business conditions.

Receipts from departmental fees and charges continue to be low and problematic.

Dividend payments from our state-owned enterprises are very low, often paid late if at all, and appear to be discretionary and the performance of most our public entities continues to be poor.

The previous government formulated a comprehensive medium term revenue strategy but we are in danger of missing many of the targets.

The Prime Minister has set a cash revenue target of K15 billion in the next two years, meaning that there will need to be a substantial lift in cash revenue over 2019-21.

This is higher than the current Medium Term Fiscal Strategy target, but it is possible if we refocus our efforts and re-energise our commitment.

In terms of fiscal expenditure, non-essential spending in the form of personnel emoluments and office rental expenditures have ballooned and continue to expand to date.

The Prime Minister has directed that control measures be implemented at these overruns and interest costs have increased, aided by Government now recognising public entity debt that was previously inappropriately guaranteed.

This higher non-essential spending has reduced spending on essential government services and the level of government arrears remains far too high for our businesses to endure. When Government pays its "dinaus" and the private sector can afford to also pay their own suppliers and reinvest.

Management of the cheque float at the end of both 2017 and 2018 has been problematic resulting in increased challenges in executing the subsequent year's budget. The main issue being, we pay, but these payments aren't banked and carried over into the next year.

Importantly this higher non-essential spending has resulted in lower capital spending from the Development Budget by the government and the reduction in available counterpart funding has adversely impacted the delivery of donor-funded projects.

In this respect, the Prime Minister has directed that spending be refocused on priority areas.

Furthermore, whilst the receipt of the proceeds from PNG's sovereign bond late in 2018 has assisted in the supply of much-needed financing and in addressing part of the foreign exchange imbalance, the remaining foreign exchange imbalance remains and it continues to hurt our domestic and foreign businesses operating here.

We need more dollars and therefore I will pursue these external options rigorously!

Therefore, if these adverse trends were to continue well into 2019, then the 2019 budget would be off track and so far the Jan to May 2019 figures show that these adverse trends in large part have continued.

These trends have negatively affected our economic growth rates and employment levels and the continued poor performance of state-owned entities has badly affected services to our people.

I have already received briefings in the main areas, and we are currently formulating policy responses to these problems but these responses need to be done within a coherent fiscal and financing program because it is easy to point out a problem, but this Government we will be focused on solutions.

In this respect I aim to ensure that the prudent targets as identified and accepted in the MTFS 2018-22 and associated MTRS and MTDS will be maintained including the medium term debt to GDP ratio target of 30 per cent and the medium term zero non-resource fiscal balance target.

This latter target will help ensure that excess resource revenues over coming years are saved in the sovereign wealth fund rather than incorporated in current spending.

To achieve these important medium-term targets, we will focus on the following concrete actions in the coming days, weeks and months:

Revenue

- a) We will accelerate the appointment of a permanent Commissioner General IRC, clarify the reporting lines from IRC and Customs through Treasury to the Treasurer and establish a set of KPIs such that the medium term revenue strategy can not only be brought back on track, but exceeded;
- b) We will accelerate the operationalisation of the Large Taxpayer Office and use a combination of improved services and targeted taxpayer management interventions to build and maintain a high level of compliance among companies where the returns are greatest. Already the IRC has engaged with Tax Auditors without Borders and more of these institutional relationships will be used to beef up our skill set and increase the capacity of our local staff in this specialized area;
- c) We will accelerate the establishment and operationalisation of the small business taxpayer regime to simplify taxpayer obligations and reduce obstacles to compliance;
- d) We will delay the implementation of the capital gains tax regime from 2020 until Treasury has brought a technical reform paper to Cabinet assessing merits and operational, sequencing and timing issues. In relation to this I intend to have a much closer and much wider

consultative process than my Department is used to in the areas of tax policy, administration and even in the drafting of the legislation;

- e) We will establish a revenue division in Treasury focused on domestic revenue and present to Cabinet a reform program to improve the reporting of the IRC and Customs revenues against key performance targets. The Division will also present to Cabinet a detailed plan to ensure the collection of departmental fees and charges, commencing with land tax collections which has promised big but delivered little;
- f) We will review the PMMR arrangements such that all relevant public entities are brought back under the budget framework and amend all respective legislation. I reiterate that this is not about starving organisations where we limit operational funding but it is about contributing to the national agenda;

But it does force these organisations to report transparently primarily through identifying what are their annual operational revenues and what are their operational costs and it is the difference between the two that the State will take. I repeat, it is post operational cost funds that we are interested in and so these organisations will have to budget and justify these budgets just as we all have to, come Budget time;

- g) We will amend the Kumul legislation to improve accountability for the pass through of dividends from trust assets, reduce the scope of non-essential activities by these entities, and review borrowing activities, including guarantees, with existing loans and underlying assets being restructured and recognised in the General Government Debt ledger and importantly improve transparency so that our economic agencies sit on the Boards of Directors and maintain visibility;
- h) Following the MYEFO, and more finalizing our financing options in the coming days will allow my Department to be in a better position to advice Government on whether an adjustment is required to the 2019 Budget. I also intend to release the Budget Strategy Paper sooner rather than later so that we put everyone on notice on the direction we are committed to, and we are planning, on our medium term in this direction.

Mr. Speaker

In relation to the **Expenditure and Financing actions;**

- a) We will instigate changed arrangements for the Organisational Structure & Personal Emoluments Audit Committee (OSPEAC) dealing with public service issues. The committee will be required to present to Cabinet a detailed paper on the short and medium term control of the PE budget including technical and policy recommendations on control measures, intake and retirement strategies, offline payments and overtime.

Currently we have one of the big four accounting firms working to give us a diagnostic on the systems which manage our payroll and our payroll execution and reporting, but I want more.

When I look at the cost of the public service wage bill from a cost per GDP perspective, compared to the region, we are just below the average. But the issue is one of affordability in which our revenues are not growing fast enough to meet our aspirations of having more teachers, doctors, nurses, police personnel and soldiers on the front line.

Let's make the management and control of our system tighter, but let's also increase our revenues so we can have these front line personnel and at the same time build our country;

- b) I have further directed Treasury to establish a much improved debt management office aimed at:

- lowering the cost of government debt and improving risk assessments,
- supplying funds to the budget as required in a more orderly manner,
- negotiating with the BPNG for much better within-year domestic cash and debt management outcomes,
- managing the external debt portfolio across fiscal years using a dedicated sinking fund,
- jointly with BPNG ensuring that the foreign exchange imbalance is extinguished fully; and
- that the domestic debt market is broadened and deepened.

Debt management arrangements are to include a review of the undrawn donor loans where substantial ongoing commitment fees are paid for little benefit to PNG. Contingent liability arrangements are to be reviewed and a transparent process established for liabilities that are crystalized;

- c) I have directed Treasury and will work closely with the Minister for Finance to establish a comprehensive arrears reporting framework and to structure the accelerated payment of all properly assessed arrears and to report the level of arrears and aging of arrears on a regular basis. Use of the cheque float at year end should be kept to a minimum amount and based solely on timing issues until such time as we can move the fiscal year;
- d) I will work closely with the Minister for Finance to ensure that the National Procurement Commission will be operationalised and implement its statutory requirements particularly related to local content in bidding, and the APC is to issue warrants for contracts only when cash is confirmed.

A dedicated trust fund will be established to secure the payment of contract amounts falling due within the fiscal year. I have also directed strict adherence to corporate governance mechanisms to reduce leakages and wastage in tendering and procurement stages.

- e) Accountability arrangements for DSIP and PSIP payments are to be strengthened to ensure that funds that flow into districts and provinces are against approved projects;
- f) There will be improved arrangements between Treasury and National Planning to ensure warrants issued for particular projects are expended against those projects but there are clear monitoring and evaluation reporting structures from skill specific areas if need be so that we can assure our people that they are receiving value for their money;
- g) I will provide to NEC first and then subsequently to Parliament a detailed report on the establishment of an endowment fund for financing tertiary fees at very low interest rates; and
- h) To streamline the public sector, the current departments and agencies merger and abolishment program will be accelerated and the coverage expanded. Public Service structures must adhere to the Establishment Guidelines from the Department of Personnel Management (DPM) at executive 4, 5 and 6 and should not build white elephant structures by having excessive top-heavy structures.

Mr. Speaker

This will necessarily be accompanied with a series of **Private Sector Policies**.

With a sound macroeconomic environment established, our new Government will concurrently introduce a number of important policy initiatives:

- a) We will pursue Public Private Partnerships particularly with our local Superannuation Funds so that our people are receiving value as end users, as vendors and as shareholders.

We have seen the value in a partial sell-down through the success that is BSP where our smaller shareholding now provides more value than our 100% ownership of PNGBC ever did. We have also seen the benefits of competition in the mobile telephony sector where players are actively pursuing customers and bringing wider coverage and lower prices.

But this is where we have stopped. This Government will explore where value can be gained in other parts of the State-Owned Enterprises story.

- b) We will establish an enlarged small business development initiative.

Our people need to be able to establish small businesses, grow these businesses and importantly dramatically expand the employment of Papua New Guineans.

There is little point in pumping significantly more into education if there are no jobs at the end of the education journey.

In this regard, among other things, we will investigate a substantial small business lending facility that will be at a low fixed lending rate for long term periods. We will partner with the banks and micro finance institutions to share risks and to fund the interest subsidy.

We will establish a simplified small business tax regime accompanied by training programs in accounting and book keeping.

We will invest in Micro Small Medium Enterprises or MSMEs E-Commerce training and support platforms to expand and formalize the current 50,000 or so companies in this sector and provide business start-up programs nationwide with the support of the World Economic Forum (WEF).

We will ensure the fiscal strategy accommodates downstream processing and value-adding in agriculture, fisheries, forestry and tourism.

The development of the capital markets to involve mums and dads in the country is also critical for financial deepening of the PNG financial markets; this will involve a review of the Capital & Securities Commission Act to improve the listing rules and governance of the Port Moresby Stock Exchange.

Through the National Procurement Commission, we will provide support for local content bidding for procurement contracts up to K10 million and for partnerships above K10 million.

We will partner with BPNG through the Centre for Excellence in Financial Inclusion and the commercial banks and lending institutions to provide electronic banking facilities to new small businesses after registering under the new small business tax regime.

We will establish a dedicated trust fund to ensure funds are available to meet approved contract payment demands on a timely basis and that a schedule of payments will be made to address all outstanding verified arrears.

The current difficulties in accessing foreign currency will be extinguished facilitating the payment for imports;

- c) Our new Government will accelerate the implementation of the Consumer and Competition Framework review and the Financial Services Sector review which have been endorsed by the previous government, but which have been slow to commence;
- d) To harness the talents of our young skilled public servants, a public sector policy research unit will be established in Treasury that will second staff from various areas to work on specific policy issues to access and stress test new ideas through new networks;
- e) We will set targets for improved spending on education, health, law and order and infrastructure, but we will establish an improved set of KPIs to ensure that this spending is well targeted and productive;
- f) Importantly we need to have a well-developed coherent strategy on the development of the power sector. Too many ad hoc projects are

being submitted, many seeking extensive concessions and government guarantees.

With the significant amount of international assistance being offered through the APEC arrangements, it is essential that a detailed plan for the supply of power across PNG is established. We will ensure that this is given top priority as this sector really has the potential to upgrade the economy directly from the people level;

- g) Similarly, we will work closely with NICTA to establish a more detailed plan for telecommunications connectivity across PNG and that the institutional arrangements for efficient and low-cost services are established. The new international submarine cable from Sydney to Port Moresby and the mobile broadband network upgrade and expansion plans should provide substantial benefits for consumers and business over coming decades.

The Government will ensure that the expansion is efficiently rolled out across the country; and

- h) We will work closely with the relevant policy agencies to significantly enhance land, sea and air transport policies to improve connectivity, safety and lower costs.

At the end of July 2019 we will have the budget outcomes for the first 6 months of 2019. My intention is then to make a wider and more comprehensive statement on the execution of the 2019 Budget in the MYEFO report.

Mr. Speaker

I would like to point out that this Government is only a month old and other sectoral Minister are still being briefed on their portfolios and their Departments. In the coming months, we will have more policy contributions from them and therefore our policy actions will take more shape then.

In the interim, in terms of budget financing needs that are now urgent, my department is in final negotiations with the China Development Bank to secure improved conditions for the promised loan made at APEC.

We are also negotiating two other loan arrangements with two International financing houses and have met with international banks to re-enter the international sovereign bond market.

The responses are all very positive and I can confirm that I will be able to recommend to the NEC, which one of the above options we will use to obtain the USD300 million planned for in the 2019 Budget.

I have also instructed my department to elevate the importance and priority of discussions with the World Bank and Asian Development Bank to secure the second tranches of their respective development policy operations.

I met with the World Bank officials who are responsible for our region last week and they agree with this approach I am taking. I have reached out to the IMF and they will be making their input in the coming weeks.

Mr. Speaker

Our challenge is to transfer the gains from our resources sector into our non-resources sector and to do that we need to progress our **Major Resource Projects**.

Managing the income streams from existing resource projects and continuing to bring Major Projects to fruition is imperative if we want to, increase fiscal inflows, increase employment, continue with our infrastructure development and improve other social and economic development outcomes.

Papua New Guinea is in the early stages of an unprecedented economic development phase based on the expansion of the mining and petroleum sector.

The strong and durable momentum in the macro-economic performance of the country that will be required if we are to reach our rapid development goals. This will be dependent largely upon our ability to successfully bring Major Natural Resources Projects online.

Furthermore, we will need to effectively harness and transparently manage and invest the proceeds from such projects to the betterment of the broader population.

Along with the newly appointed Ministers for Petroleum and Mining, the Hon Kerenga Kua and the Hon Johnson Tuke, we will be establishing a much improved framework for the management of resource projects and pursue the major resource projects such as Papua LNG, The Exxon Mobil led Third Train, The P'nyang Project, Wafi Golpu and Frieda River that the Prime Minister has been talking off lately.

There have been concerns raised by the Community, by colleague Ministers and Members of this honourable House. Let us address them quickly and make some decisions.

Our future prosperity depends on delivering these projects and delivering them well. But we must now find a way to ensure that these major resource project agreements capture enough value to the State and to our people, including local landowners, so as to deliver on our people's aspirations.

This Government will be further exploring different fiscal regimes for resources to modernize the elements of tax legislation. We have commenced the shift to production taxation in Papua LNG and we aim to have this across the board.

To this end, together with the Ministers for Petroleum and Mining, I have been instructed to immediately provide a detailed account of all of the benefits received from the PNG LNG Project since inception and account for how these monies have been spent.

I will request the Department of Treasury and ExxonMobil as operator of the PNG LNG Project to immediately enter into a discussion aimed at providing renewed detailed forecasts of future cash flows from that Project to the National Government, Provincial Governments and the Project Area Landowners for the remainder of the Project.

The Government intends entering into discussions with Total E&P PNG Limited as operator of the Papua LNG Project with the aim of more fully understanding the resource base, scope and benefits forecast to flow to the State from that Project.

There is a missing piece in the LNG expansion Project at the moment and that is a Gas Agreement in respect of PRL 3, P'Nyang. Too often, the State is approached by Project Partners under the cloak of separate Joint Ventures, thereby forcing us to analyze and compromise based on a view of individual Joint Ventures only.

The development of the Papua LNG Project, the P'nyang Project and the PNG LNG Project are all inter-linked.

I am putting each of the Project Partners in all of these Projects on notice that the concerns of our people must be addressed through dialogue and negotiations with the State and that we expect all parties to contribute to a fair and equitable outcome.

The Government is expected to instruct the State Negotiating Team for the Wafi Golpu Project to immediately enter into discussions with the Morobe Provincial Government and other stakeholders to understand the aspirations and requirements of these stakeholders before proceeding further with discussions with the Project Sponsors.

As the honourable House knows I represent the people of Bulolo including the landowners from Mumeng LLG.

I am also a mandated leader from Morobe Province.

Recognising the need for Wafi Golpu Mining Project to come onstream in all leadership capacities, I am calling on all stakeholders to work closely together to ensure the rights of our people are protected, and also ensure that the project progresses on its timeline so that the Morobe people are contributing to the development of our nation.

But we are also in preparation for reviews in the Porgera Mine and the Ramu Nico Mine. These are opportunities again to raise these resource issues with the developers.

Mr. Speaker

I now commend this economic status report to the Honorable House.

Thank you!

Hon. Samuel H Basil, MP
Treasurer