

37TH AUSTRALIA PAPUA NEW GUINEA BUSINESS FORUM 2022.

BRISBANE CONVENTION AND EXHIBITION CENTRE, AND ONLINE

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“PAPUA NEW GUINEA: BACK TO ITS FUTURE - A CLIMATE FOR CHANGE.”

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2022 Budget Analysis

Many thanks to our hosts, the Australia-PNG Business Council and the Business Council of PNG for the invite to speak once again at the Forum, and its really good to be able to attend again in person and be back here in Brisbane...

Recent years keep reminding us that forecasting economic and Budget performance are challenging, with outcomes subject to highly unpredictable variables, driven both externally and domestically. Nevertheless, it might be noted that PNG's budgets, which used to be consistently on the conservative side, over the past decade have routinely over-estimated revenue, and under-forecast expenditure and deficits.

PNG, lying both within the wet tropics and on the Pacific Ring of Fire is invariably subject to natural disruption, but in recent years natural and human-induced disturbance, including regional geopolitical uncertainty, have been escalating in this region and worldwide.

2018, and the past three years all commenced with optimism of firm economic and fiscal recovery in PNG after several difficult years. No one forecast the terrible earthquake of 2018, and few forecast the global pandemic at the start of 2020, with its extended impact on entire value chains, world trade and national budgets, apart from the health and welfare effects.

As recovery was materialising from late 2021, few predicted that this year would start with the invasion by a superpower of a medium-sized neighbour, both resource rich nations, causing further human suffering, but also major disruption to global energy and staple food markets, and fuelling inflation, that

was already rising in many countries, but risks evolving into stagflation in some countries, with longer term damaging economic consequences, if not reined in by concerted local and international action.

While many Papua New Guineans still remain partly outside the market economy, and although PNG was less impacted by the GFC than more globally integrated financial markets, the country is increasingly embedded in the global economy, and impacted in turn by the vagaries of global markets, including to its national Budget.

Let's Quickly Recap:

PNG still has a relatively small economy – frankly, substantially too small for a land of nearly 10 mill people and with its resources. It had a relatively low but steady growth rate for its first 14 years from Independence, but that was followed by disruption in Bougainville and a turbulent decade of economic and fiscal crises in the 1990s, which should have provided warnings against exaggerating expectations of early revenue flows from big resource projects. The 2000s brought a period of firm growth, on the back of initial structural reforms, and then stronger commodity prices and relative fiscal stability and prudence, which also enabled public debt to decline from 70% of GDP to about 24%; on the other hand public infrastructure and services were steadily deteriorating, except where, as with telecommunications, they were exposed or taken over by private investment and competition.

The past decade commenced with a surge of growth on the back of the construction phase of PNG LNG (and nominally from the commencement of gas production), but thereafter the economy was subdued for rest of decade, in the face of low commodity prices, policy uncertainty, lack of foreign exchange and limited new private investment. The non-resource sector, apart from oil palm and vanilla, and some fresh produce for the domestic market, have been particularly subdued.

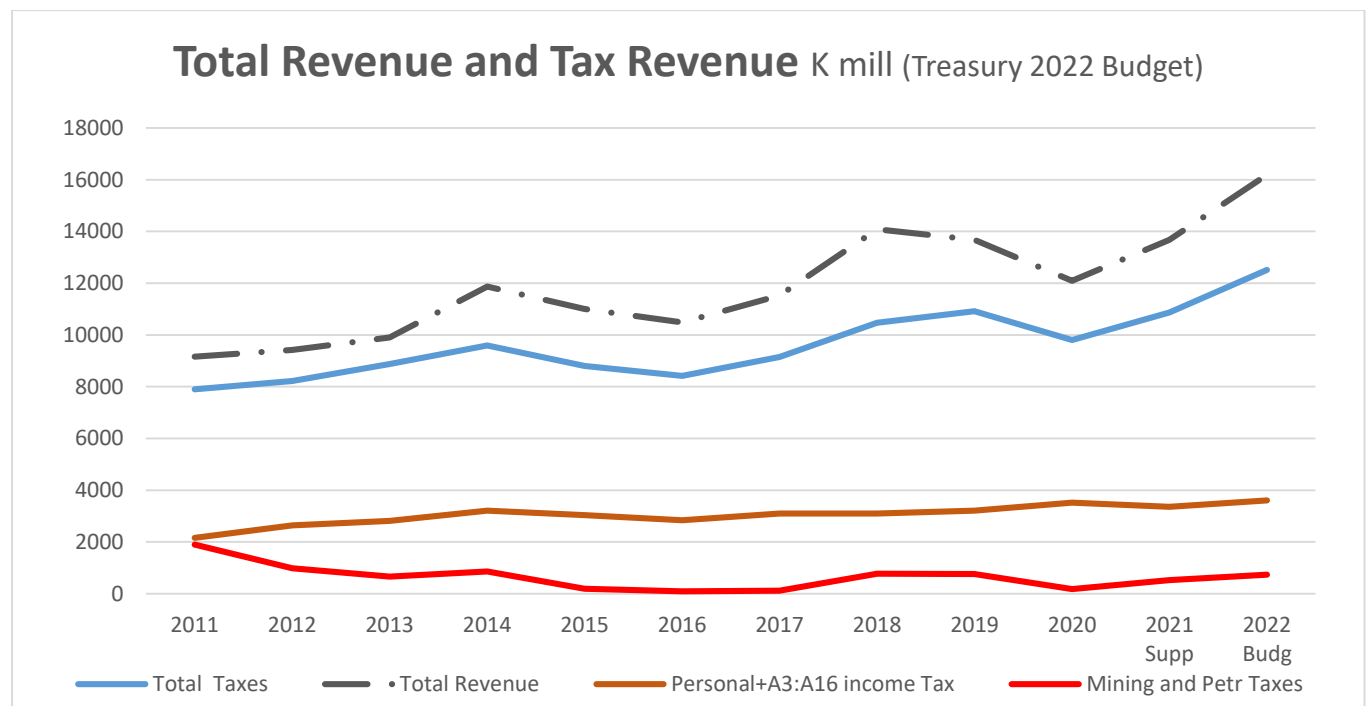
Throughout the past decade the government had forecast strong revenue growth, especially from the resource sector, but the reality proved very different, especially in 2016-17. The Government had ambitious public expenditure ambitions, for infrastructure, education, but also for equity acquisition, but the revenue didn't materialise. Moreover, expenditure control also weakened. This left the Government resorting to major public borrowing, largely from domestic, but also from international commercial, as well as

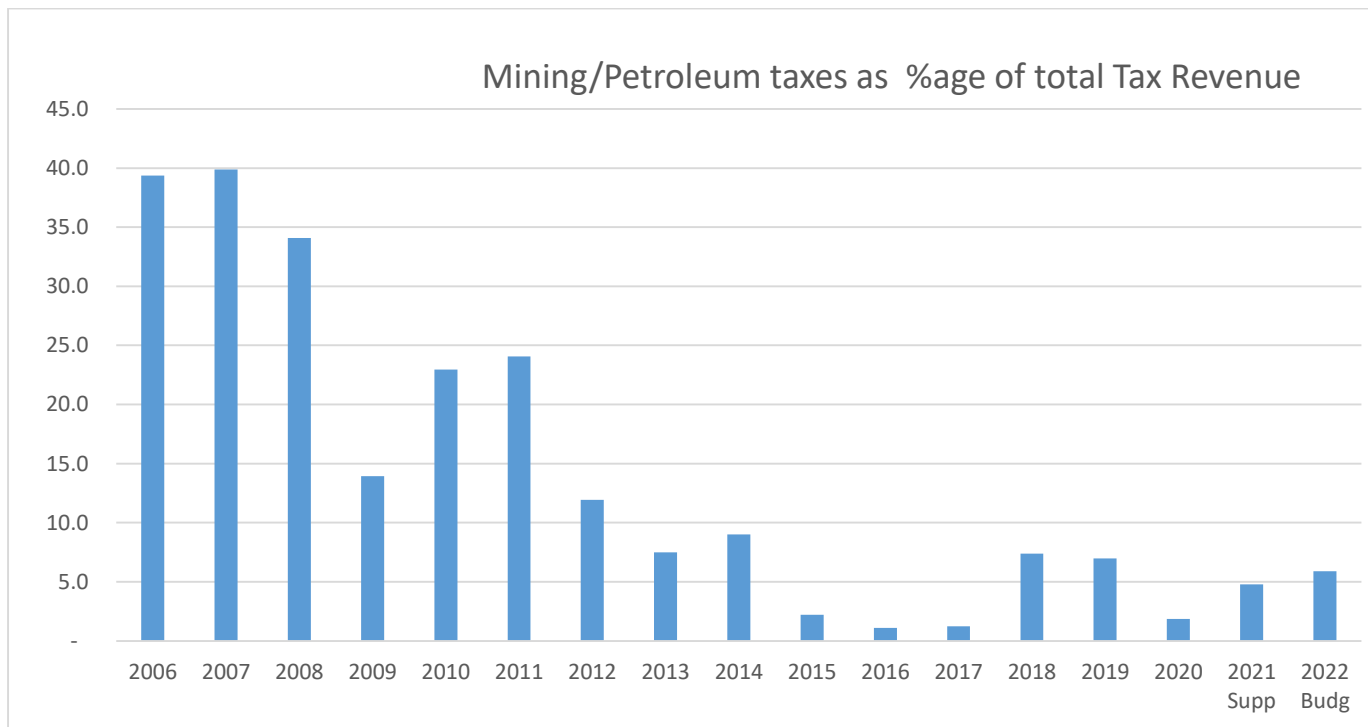
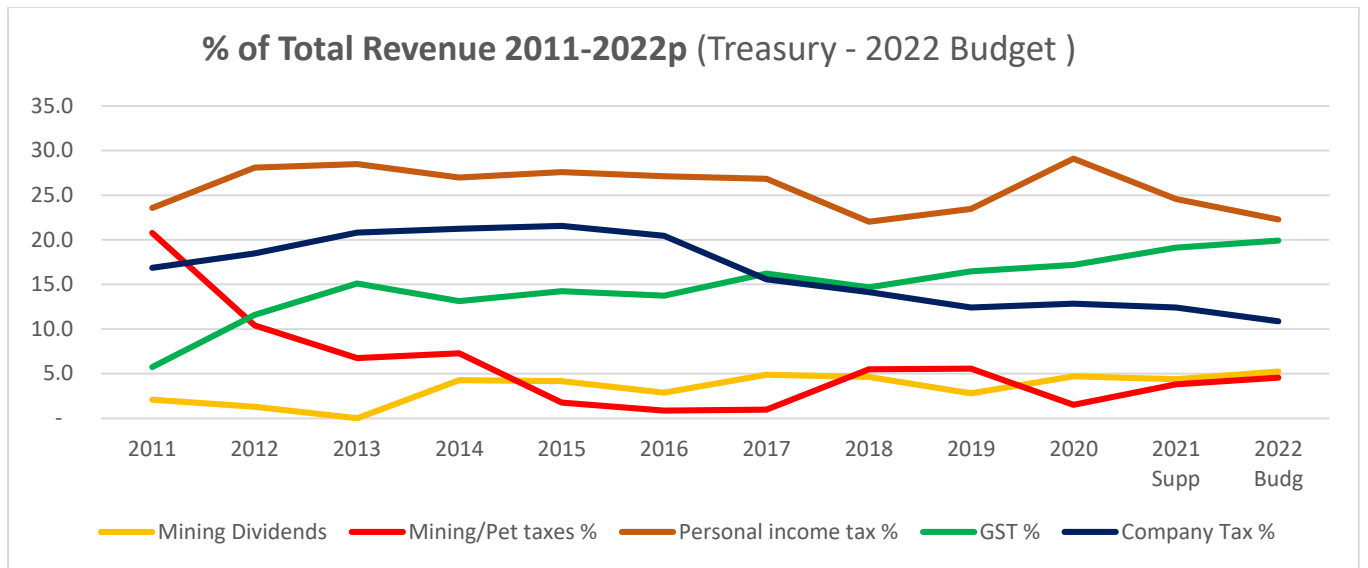
concessional sources, leaving a substantial Budget deficit annually from 2012, accumulating national debt and increased debt servicing costs.

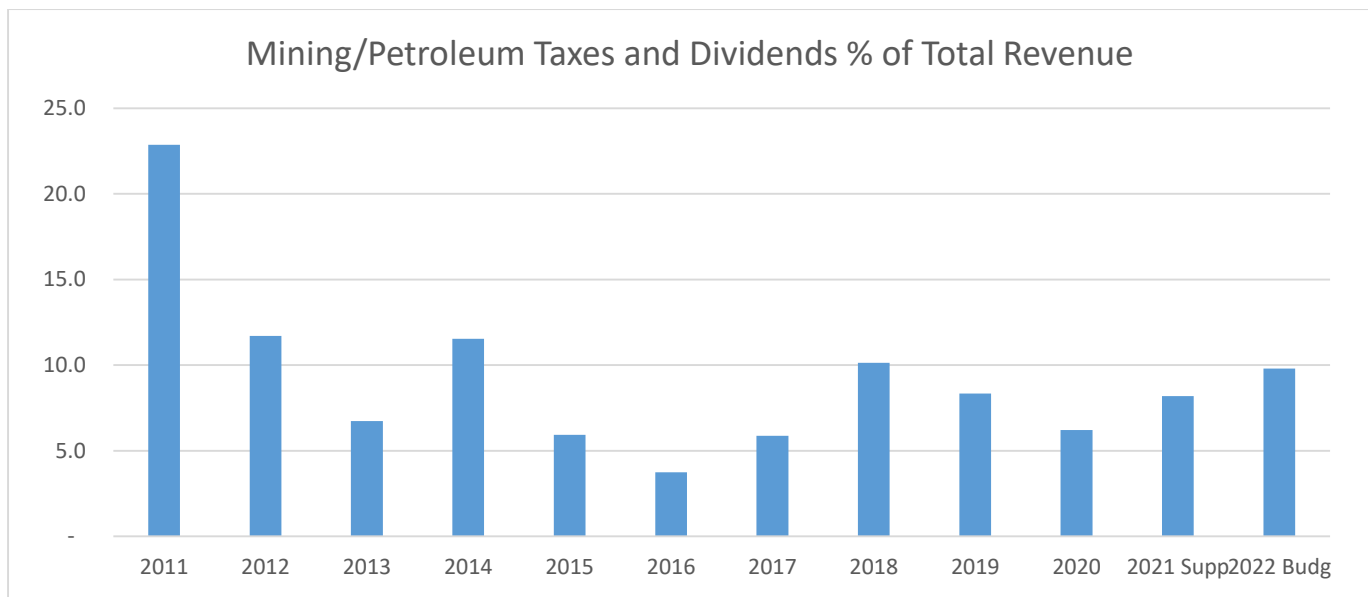
At the end of the decade, with improving commodity prices and PNG LNG's debt diminishing, there were expectations of improved economic and fiscal conditions. Indeed 2019 saw firm economic growth (at 4.5%), especially in the resource sector, but this was not reflected in revenue, which shrank slightly, and with weak expenditure restraint, the deficit increased to K 5 billion, debt servicing to K2.5 billion and total debt rose to K33.7 billion in 2019.

The Pandemic:

The pandemic, with its disruption of markets and business activity, combined with uncertain policies over FDI and, frankly, an 'own goal' over the Porgera gold mine, put pay to the expected economic and fiscal recovery, and pushed several thousand employees at the mine and amongst contractors out of work and no longer paying S & W tax.







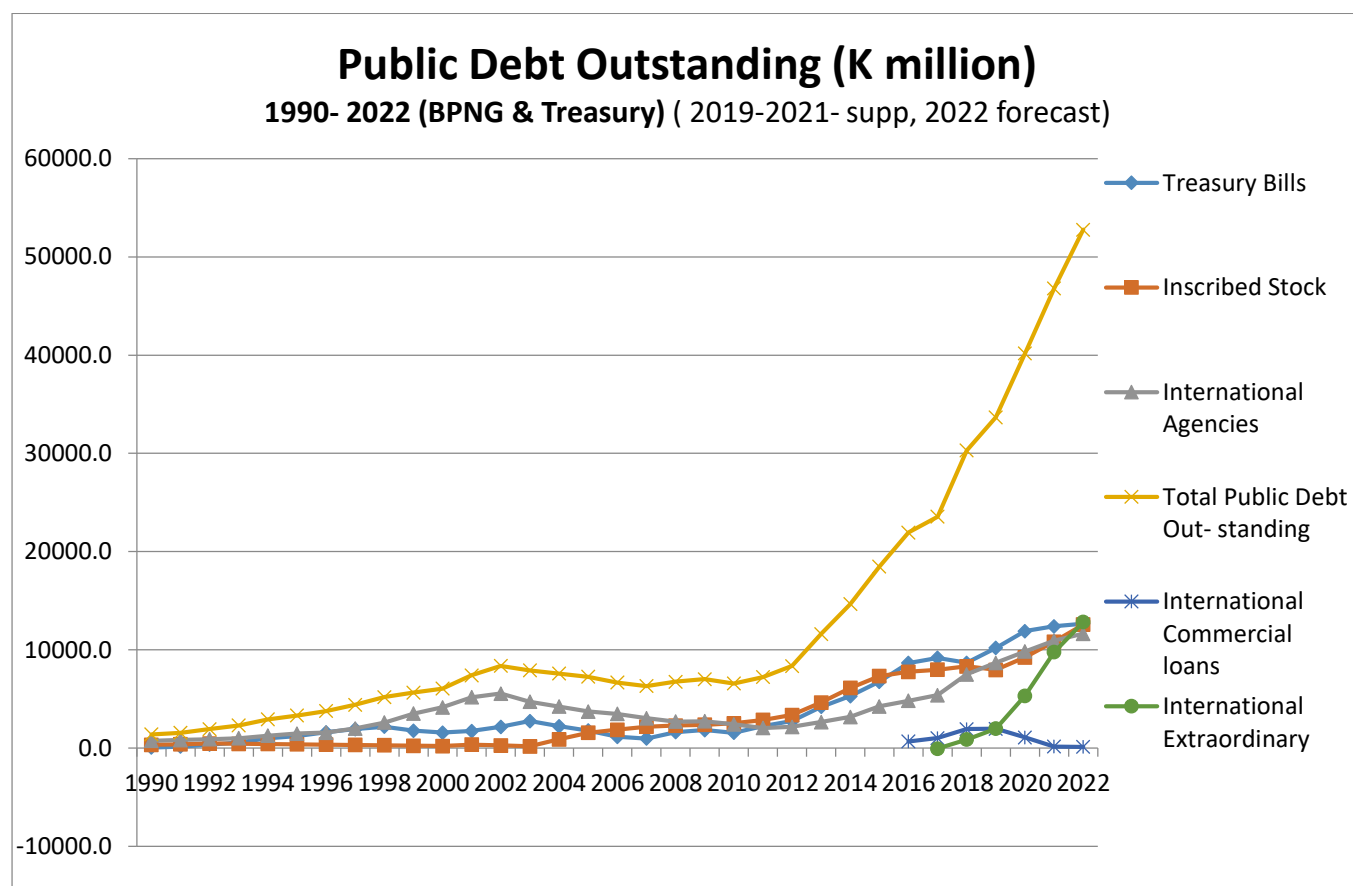
Although official statistics severely under-record fatalities from Covid-19, particularly in 2021, in some regards PNG's economy was less directly impacted by the pandemic than many other countries, including those in this region more substantially dependent on single industries, like tourism. High gold prices provided a partial fiscal safety net, while some major agricultural prices held up, and PNG avoided the extended lockdowns of many of its neighbours, partly as they would have been impractical and cause severe impact in a country dependent upon household production and trade and lacking any public social protection system.

On the other hand, following eight years of deficit financing and appreciating debt, the public purse was in a weak position to be facing any crisis, whether from a pandemic or subsequent crises.

More transparent reporting on debt from 2019 contributed to the higher debt figures, while access to more concessional funding enabled overseas commercial loans to be displaced to fund the deficit. This led to more stable and then reduced debt servicing costs in 2020 and 2021 (down to reported K2.2 billion for 2021), despite total debt rising to K46.8 billion or 50.1% of GDP at the end of 2021 (51.3% from other sources). The ceiling on allowable debt to PNG has been progressively raised from 30%, when introduced under the Fiscal Responsibility Act in 2006, now to 60%.

The figure itself may not be sacrosanct in terms of fiscal management, but it's intended to provide needed discipline. Other countries may have higher debt to

GDP, but it depends upon sustainability and capacity to service the accumulating debt. Unfortunately, the productivity of the PNG public sector and the utilisation and output from the public funds borrowed is poor, and cautions the need to review and focus public expenditure before further borrowing, especially from higher cost sources, including EXIM banks.



The utility and accountability of public expenditure during the pandemic, including for commodity price support, business support and other measures, were another matter, with large portions of the public sector, apart from schools, barely functioning, although sustaining the public sector workforce through the pandemic helped sustain demand for other parts of the economy and contributed to PNG's community social support system.

Recovery from the Pandemic's Economic Shrinkage:

Economic and fiscal recovery was envisaged globally and in PNG in 2021, but with the extended impact of the pandemic, it was only in the late months of the year that the lid was lifted, leading to a global recovery in demand, rising commodity prices, supply constraints and the re-emergence of inflation. Porgera had also been forecast to open in 2021, but that aspiration is still pending in 2022.

2020 GDP shrank 3.5%, and 1.2% in the non-mining sector, according to the Treasury. For 2021, Treasury estimates the economy grew by 1.5% and 3.9% for non-mining (the World Bank estimates a lower figure of 1% overall growth). For 2022 the Treasury forecasts growth, or rather recovery, picking up to 5.4%, and 3.5% for non-mining; the Bank's forecast early in the year was for a more modest 4% real growth.

The Treasury's forecast for Revenue, including grants, for 2022 is K16.1 billion, picking up from 2020 and 2021, but well down on K17.7 billion in 2018. Revenue comprises of K12.5 billion in Taxes, up from K9.8 bill in 2020 and K10.8 bill in 2021, and with dividends increasing to K1.3 bill, from K0.9 bill in 2020 and K1.2 bill in 2021. Mind you we've not yet seen the Final Budget Outcome tables yet for 2021, which should have been released by the end of March.

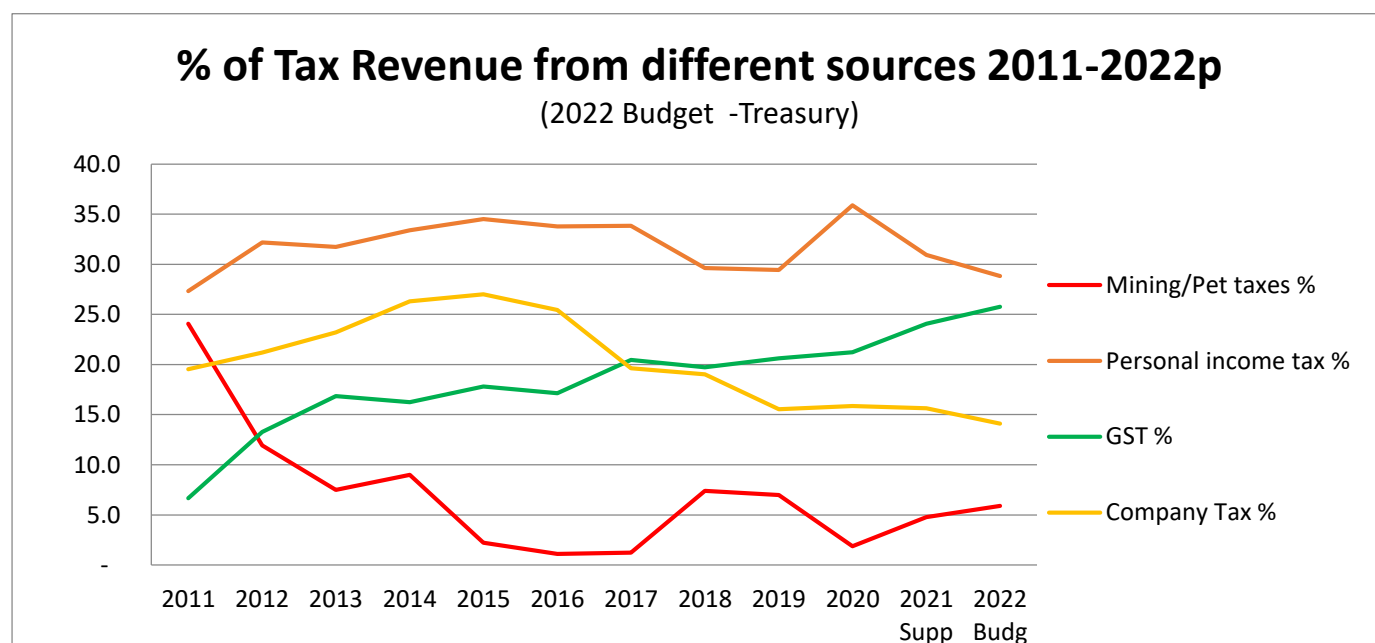
The Treasury forecasts resource revenue, comprising taxes and dividends, as picking up in 2022 to K1.6 billion, from K0.7 bill in 2020 and K1.2 billion in 2021. The World Bank's forecast is for K2.1 bill in 2022, but the variation is largely based upon including additional revenue components under the sector.

Expenditure for 2022 is forecast by Treasury at K16.9 billion, including debt servicing of K2.3 billion, up from K15.9 bill in 2020 and K16.4 bill in 2021, leaving a deficit requiring financing of K6 billion for 2022, down from K7.3 bill in 2020 and K6.6 bill in 2021. However, with expenditure control deficient each year, particularly for the public sector payroll, and revenue usually below forecast, the deficit has tended to push beyond its forecast.

A week, however, is a long time in politics and for the PNG economy and public finances. Although PNG's economy may be more diverse than various neighbours', government revenue is dependent upon a segment of the economy which is indirectly based upon volatile markets. Revenue is disproportionately dependent upon tax revenue, at a reported 82.6% of total revenue, with personal tax comprising around 30% of tax revenue and GST rising from 6% of tax revenue in 2011 to 25% by 2021. IRC is reporting record tax collection over recent weeks, but the basis of that remains a little unclear, and Treasury has resorted to some opportunistic revenue measures, notably with its dominant industry tax in banking and telecommunications. Hopefully, however, during the year revenue will be able to pick up in some industries on the back of the stronger than forecast commodity prices, but this must be weighed against the higher business and household costs from high energy prices, if the Ukrainian conflict and associated sanctions are sustained.

Revenue is particularly dependent upon the non-resources sector, and yet this has largely been the more struggling portion of the economy, facing the high costs, relatively strong exchange rate and risks, from which the major resource projects are more immune. Resource projects provide a surprisingly low portion of tax revenue, compared to 2007 when they provided 40% of total tax revenue, and 2011, when they provided 23% of total tax and dividend revenue. This is surprising, considering PNG's designation as a resource rich country, with major recent developments.

Some projects, such as Ramu-Nickel, have been conceded long lead-in periods prior to subjectivity to corporate or certain other taxes. Repaying project financing loans for the PNG LNG project, leading to higher tax payments has taken longer than envisaged by both Government and the public, but higher prevailing energy prices, if sustained, should enable more positive progress, but details should be clarified. On the other hand, it must be recognised that the construction phase and more established operations of resource projects contribute major employment and associated group tax, and a variety of other fees and charges, and, as with petroleum, gas projects and fisheries, major transfers are provided to rent collecting public sector middlemen, including SOEs and Authorities, allowed to divert substantial portions of eligible and needed revenue.



We may be far removed from Ukraine, but the impact of the conflict on energy and staple food prices permeated promptly to PNG's markets, with contrasted repercussions on businesses and households, and Budget performance in

different ways over the course of time, depending partly on the duration of the conflict. There are invariably beneficiaries, as well as victims, from most natural or human-induced calamities, whether frosts, droughts or wars, through impacts on markets and commodity prices, and that's the case also with Ukrainian crisis. And even within countries as remote as PNG, there are relative winners and losers, including Budget impacts, with higher fuel and staple foods costs potentially impacting essential public service delivery, including for schools across the country, while higher current prices for a range of commodities provide opportunities for various agricultural producers, as well as resource companies, and in due course for revenue.

Role of National Budget in PNG:

In considering the performance of the National Budget, we should examine its role in PNG: how it impacts, but also how it in turn is impacted by the wider economy and workforce.

In PNG tax revenue is disproportionately low in relation to GDP, and apparently declining since 2011, when according to the World Bank, it was 18.6%; by 2016 it had fallen to 13% and has since remained at that level. This has been compared with the average for Asia and the Pacific of 23%. While GDP is a poor reflector of an economy like PNG's, with its relatively heavy dependence on international capital, particularly for larger projects, it also partly reflects the nature of the state engagement with the sector, with its strong focus on acquiring public equity in major resource projects. Resource revenue is increasingly tied up in state-owned enterprises, such as Kumul Petroleum Ltd, and some authorities, like the Fisheries Authority, running parallel budgets and investment portfolios, but effectively denying the State needed revenue for priority expenditure (and seemingly sidelining the requirement to release 70% of income to the State), as well as deferring the prospects for operationalising the Sovereign Wealth Fund, as a transparently-managed stabilisation and future fund for the country.

Why does the Budget matter households and the Business Sector?

It matters, partly because it's financed by PNG households and businesses, and influences the level of purchasing power left to them, and therefore their own capacity to invest. In PNG the burden of taxation falls on a relatively small portion of the population working in the formal sector, and increasingly upon GST collected from households and businesses. It's also collected through a range of taxes, fees and levies on businesses, but with a disproportionate

burden falling on some formal enterprises, and understandable concern over seemingly arbitrary or opportunistic taxes being imposed at short notice, generating costs and business uncertainty.

It matters, because the level of expenditure determines the level of taxation and public borrowing, which has been accumulating since 2012 and forecast at K52.7 billion by the end of 2022, which must be serviced and ultimately repaid by taxpayers, as well as influencing availability and cost of private capital.

But it also matters, because government entities provide a disproportionate level of goods and services and formal sector employment in PNG, albeit delivered through 1,420 public institutions, many of which perform at a low to very low level of efficiency. Greater public awareness, engagement and oversight of the Budget process and outcomes are critical to improving its utility, performance and accountability.

Public expenditure is meant to be guided by the priorities set out in the five year Medium Term Development Plan 2018-22, and the associated Health, Education and other plans, developed partly through extensive consultation processes. However, when it comes down to it these various plans are widely side-lined, with the capital investment in the Budget allocated to various, often high profile projects, (such as grand hospitals or multiple universities, when the priority is for accessible rural health capacity etc), inconsistent with the plans and sector needs, notably for restoring public goods and service delivery. DSIP and PSIP funds are widely accumulated for the final years before elections, when they cannot be expended in a planned and accountable manner.

Rationalising the public sector, so that it adequately funds and delivers its core functions more effectively, while pruning, stepping back from or in some cases privatising other functions, which are lower priority, duplicative, or could be performed with greater market rigour by the private sector, would provide greater value for money, and better outcomes for PNG households and the business sector. It is the private sector, from large corporate entities to micro-enterprise, that should utilise the improved investment conditions, to innovate, invest and generate the desperately needed employment required for PNG's fast growing young population, and then in turn generating more extensive and sustained revenue to enable the State to perform its functions.

I've just come from S Korea, where successive speakers, including a leading economic professor at the University of Korea, emphasised that Korea does not

have SOEs, that's something for developing countries, it has more dynamic and competitive large and small to medium enterprises delivering almost all goods, albeit that some gained support from the government in their development. He also emphasised, incidentally that local Special Economic Zones are also for developing countries, and that S Korea focuses on making the whole country an SEZ, which is a far more efficient and productive model.

Those expenditure priorities to reduce costs and opportunities for business and investment, and to generate critically needed employment growth in the face of a growing population, include:

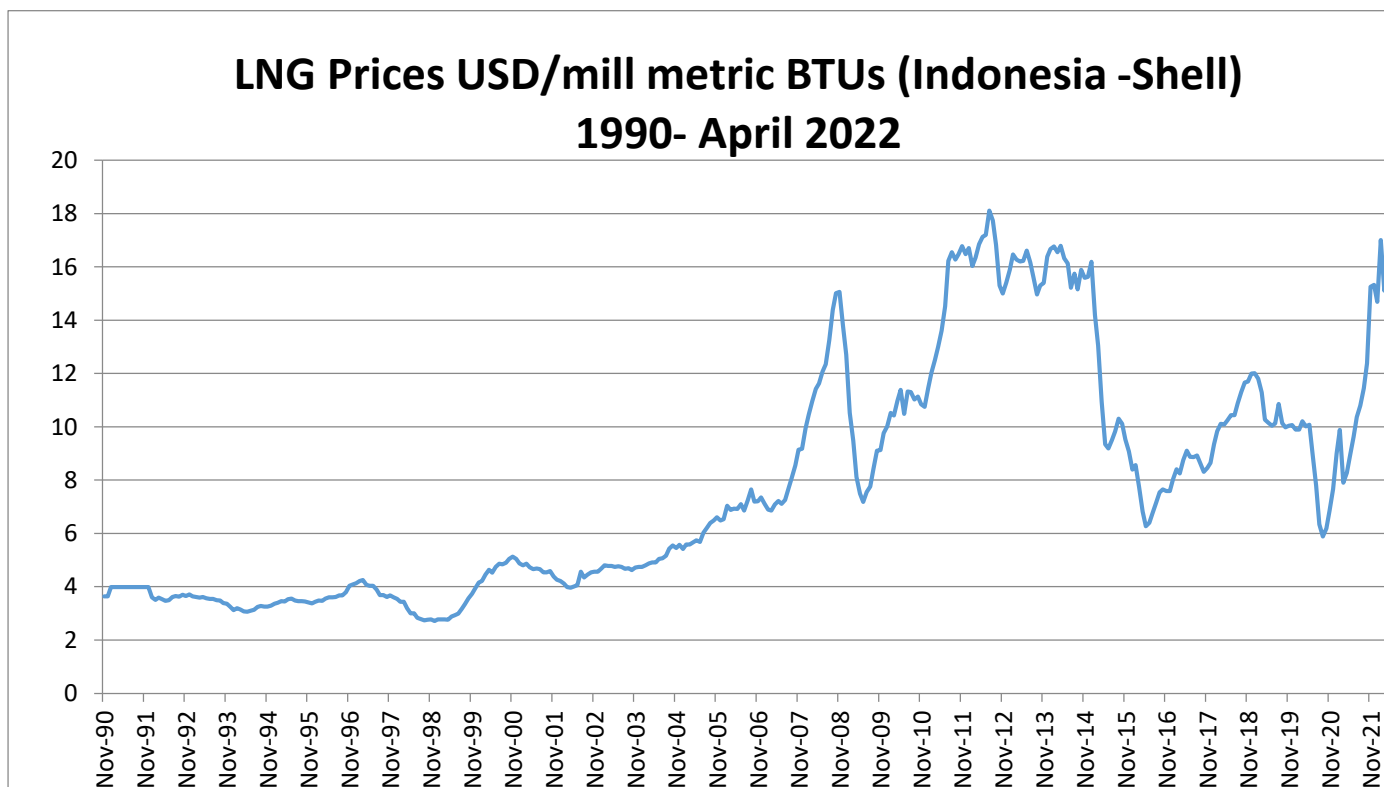
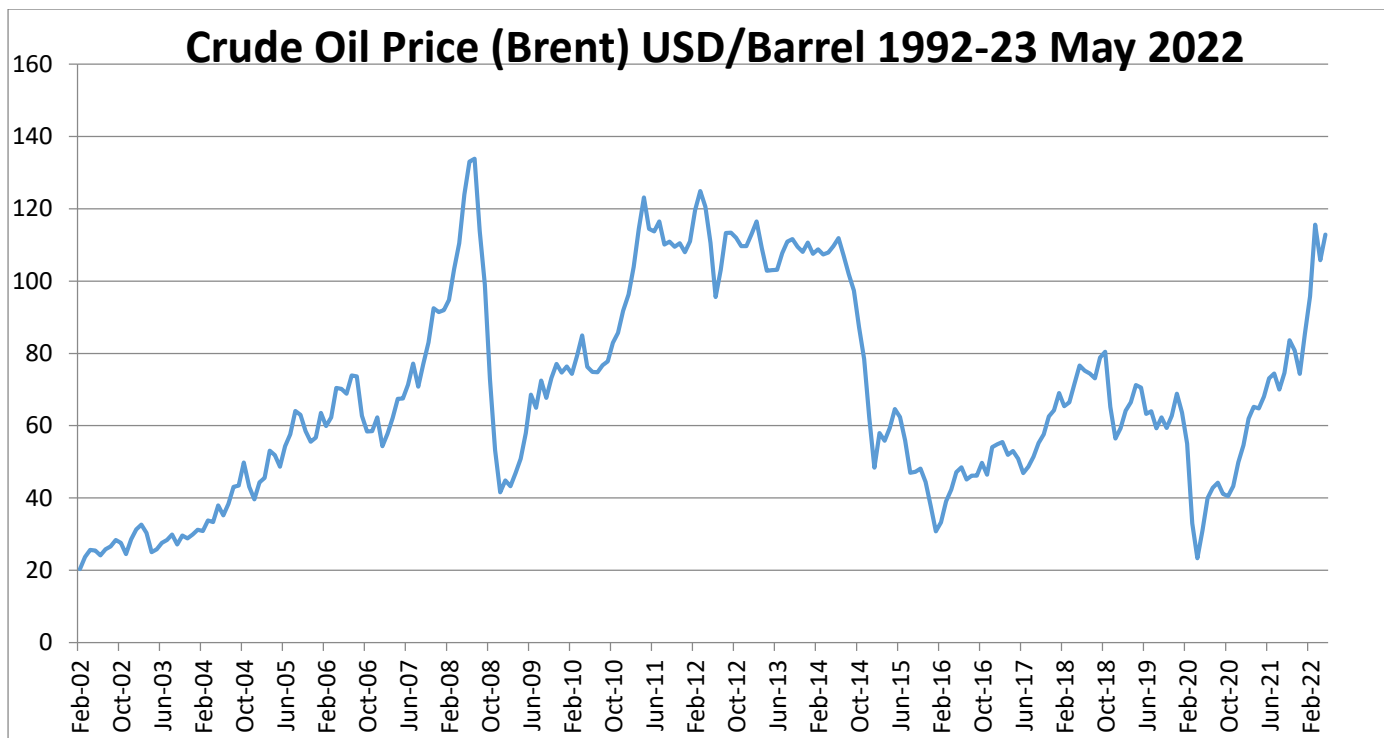
- enhanced and essential infrastructure, financed and procured competitively, notably for reliable transport, market infrastructure and power, while leaving telecommunications largely to the private sector,
- Upgraded law and justice services for enhanced public safety and more effective, timely and accountable application of justice and dispute resolution,
- quality, accessible and relevant lower to higher education and training capacity, as needed by PNG's young men and women, enabling the skills required to drive and participate in the formal and informal sectors, including developing start-ups, as well as in the public sector,
- effective governance and accountability across the public sector, including freedom of information, procurement, audit and other oversight institutions, but also providing a sound and efficient regulatory platform for business operations, and for civil society to secure needed documentation in a timely manner, ensure competition and oversight; the recent passing of legislation on whistleblowing, unexplained wealth, ICAC and plans for rights to freedom of expression are all progressive, but need to be resourced and applied effectively to be meaningful, including adequately resourcing the entire public auditing process to ensure timely and comprehensive public accounts,
- reliable and accessible health services, avoiding expenditure on costly status facilities and overpriced and unsuitable equipment and pharmaceuticals
- Administer the democratic process in a timely affordable and credible manner; democracy is a demanding process to ensure its engagement and credibility, but it needs to be nurtured and actively supported to function effectively. With built in mechanisms for accountability and

responsiveness, democratic processes, despite their inherent challenges for business, provide the best platform for sustainable business and economic development, as opposed to autocratic regimes with their inherent tendencies to patronage, corruption, repression of human rights and freedom of expression and other abuse of power

In terms of revenue measures, the objective is for a fair, equitable (between investor and the state and the other stakeholders – eg. Provinces, landowners etc) and well administered revenue system, extending the tax base and minimising undue incentives or opportunities for tax avoidance.

It should seek to make investment attractive, providing a competitive and reasonable return on innovation and investment, while enabling the Government to be able to secure the revenue required for its core regulatory, service and welfare functions, to support development and sustainable budgeting. This includes the State gaining the revenue to be able to provide the public goods needed by the community and for business and economic development.

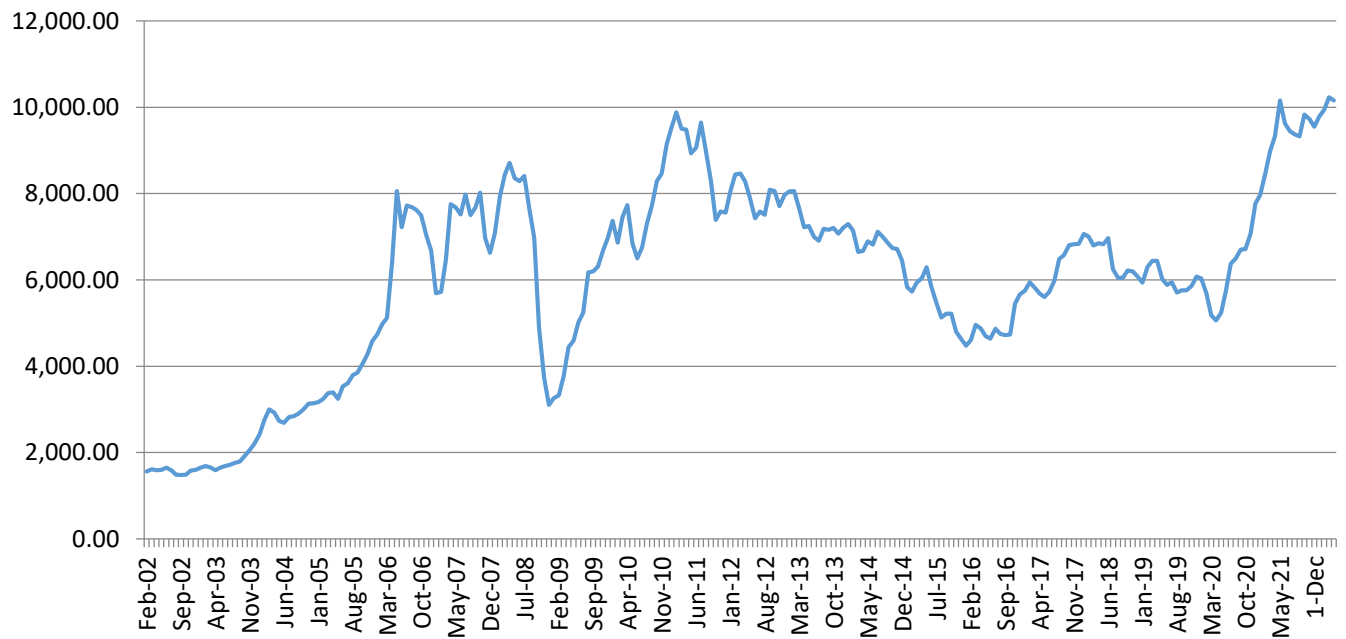
Seeking the optimal tax system is not the objective, as its pursuit can be highly disruptive; rather the aim should be to ensure consistency and investor confidence and stability, as far as possible, to encourage long term investment by credible domestic and overseas investors, committed to responsible, longer term investment, and to PNG's economic and social advancement, and safeguarding the natural environment, which is the basis for most livelihoods and the country's sustainable future.



Gold Price USD/troy ounce 2002 - 23 May 2022



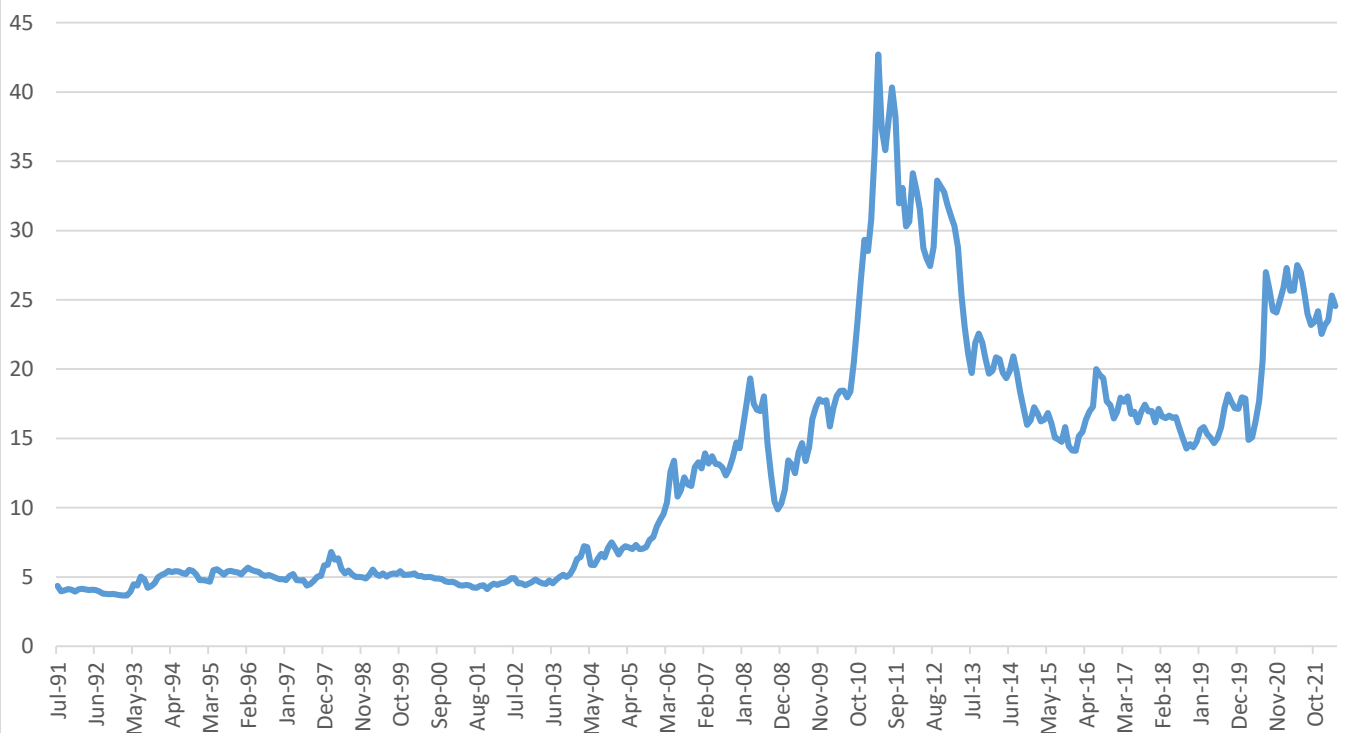
Copper Gde A USD/tonne 2002-28 April 2022



Nickel, melting grade, LME spot price, CIF European ports, US Dollars/Tonne, Mar 2002- Apr 2022



Silver, USD per troy oz, Jul 1991- Apr 2022



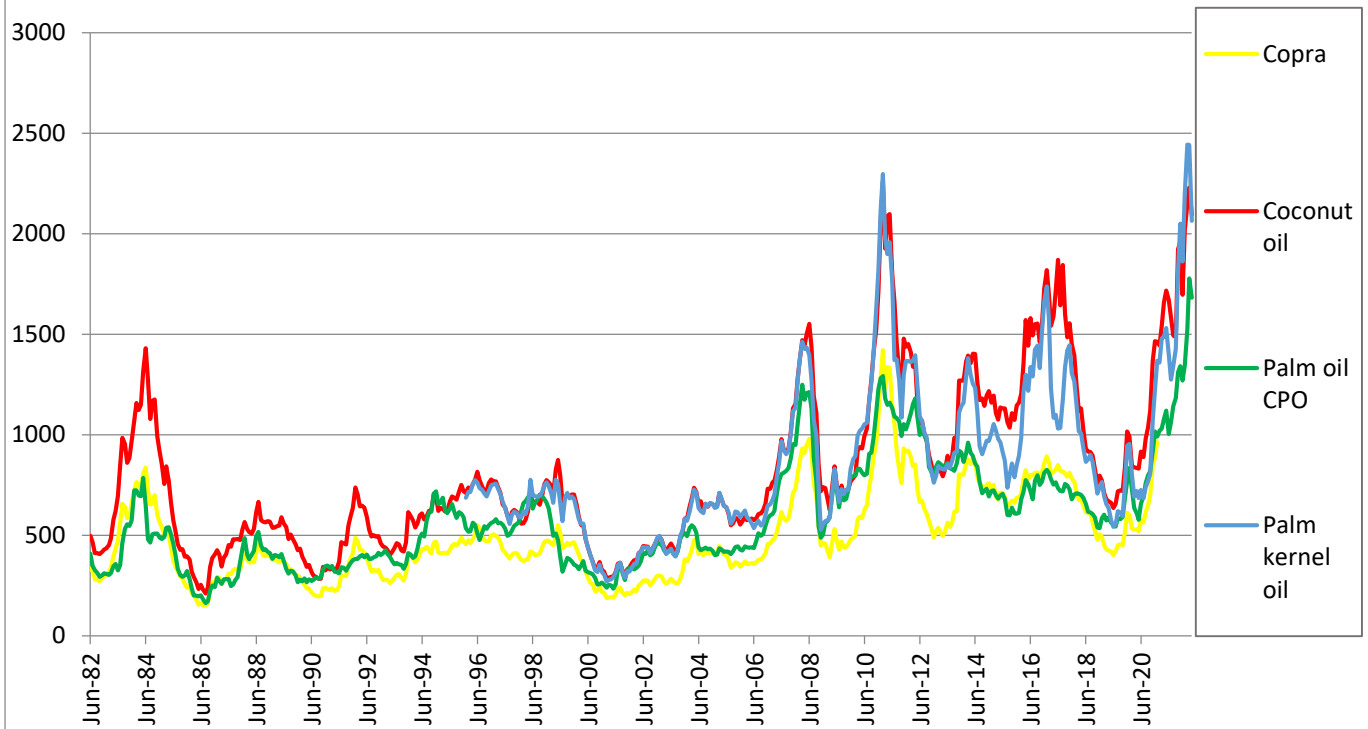
Wheat Price (US exports) USD/tonne (Apr 1992-Apr 2022)



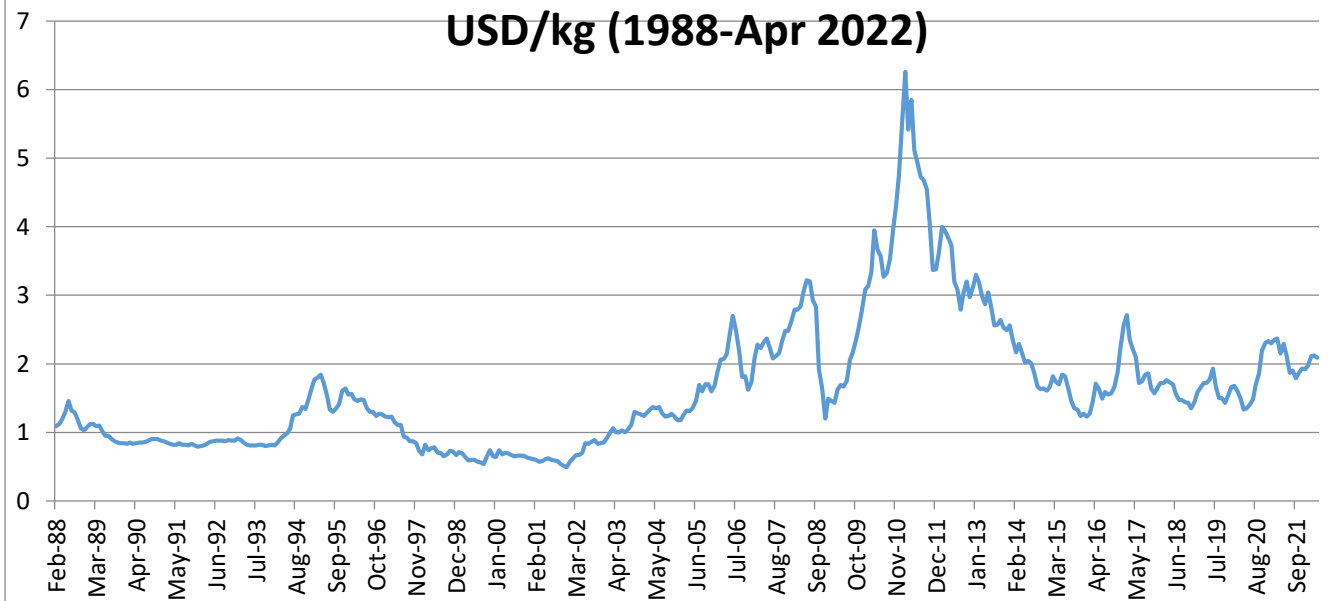
Rice (Milled White) USD per tonne
Dec 1991- Apr 2022 (Thailand -quote)

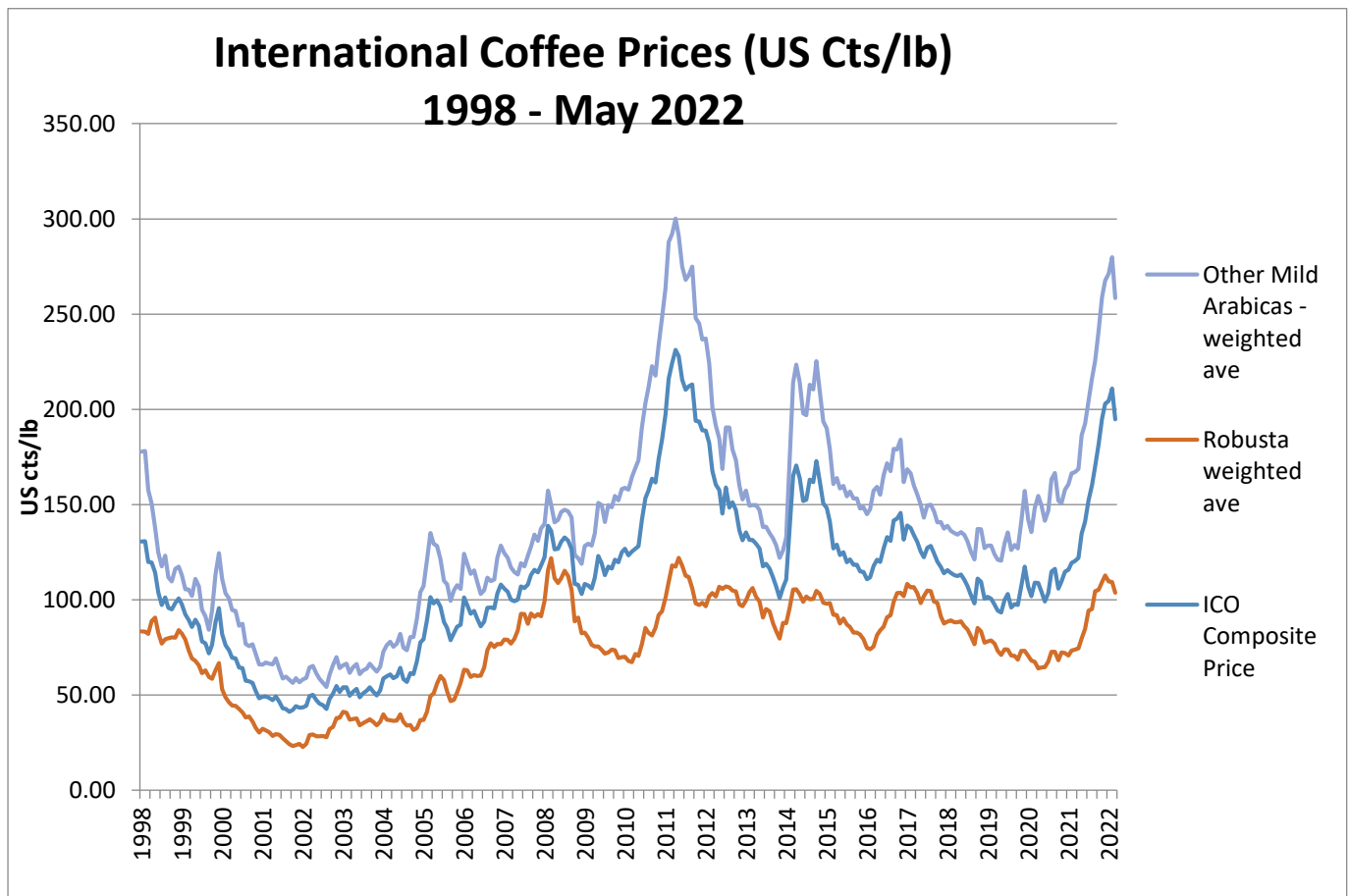
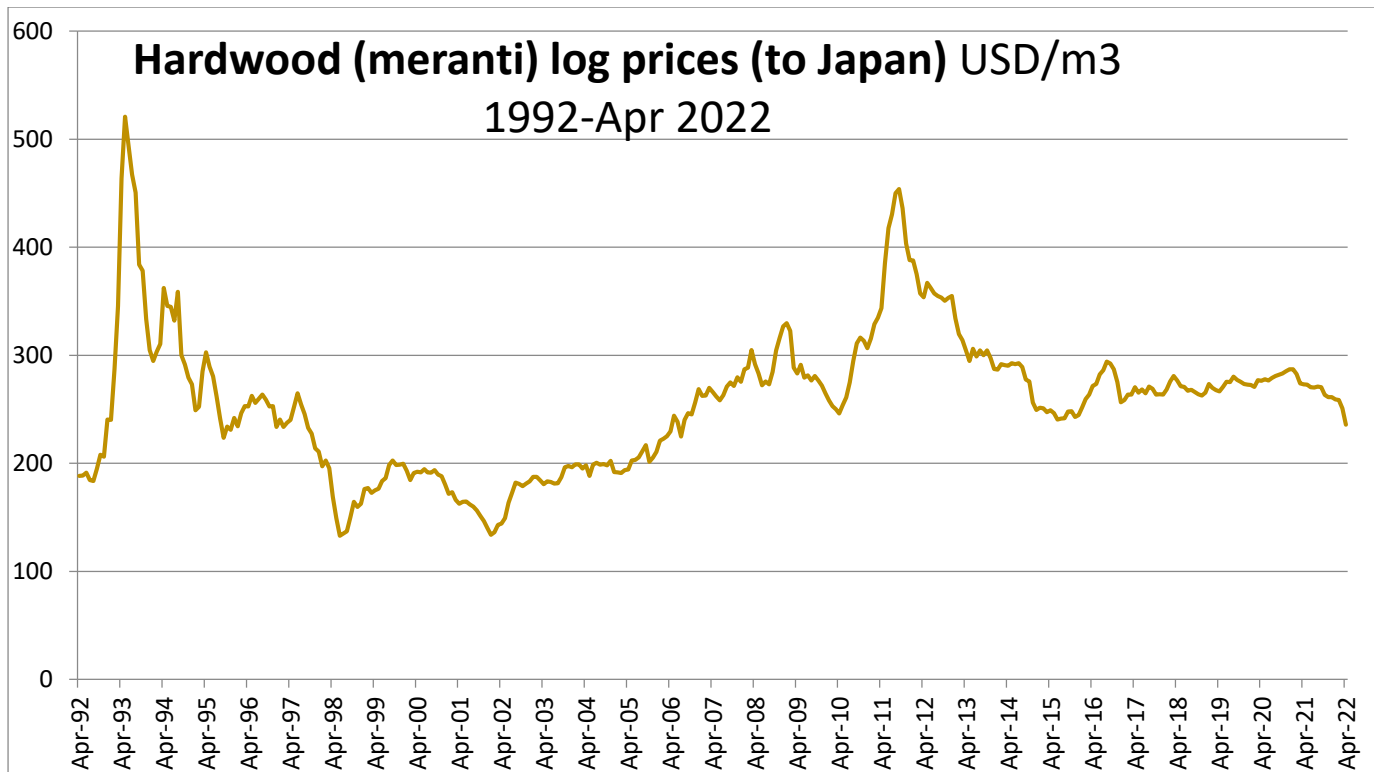


**palm oil and coconut oil prices (fob), Jun 1982-Apr
2022 USD/tonne**

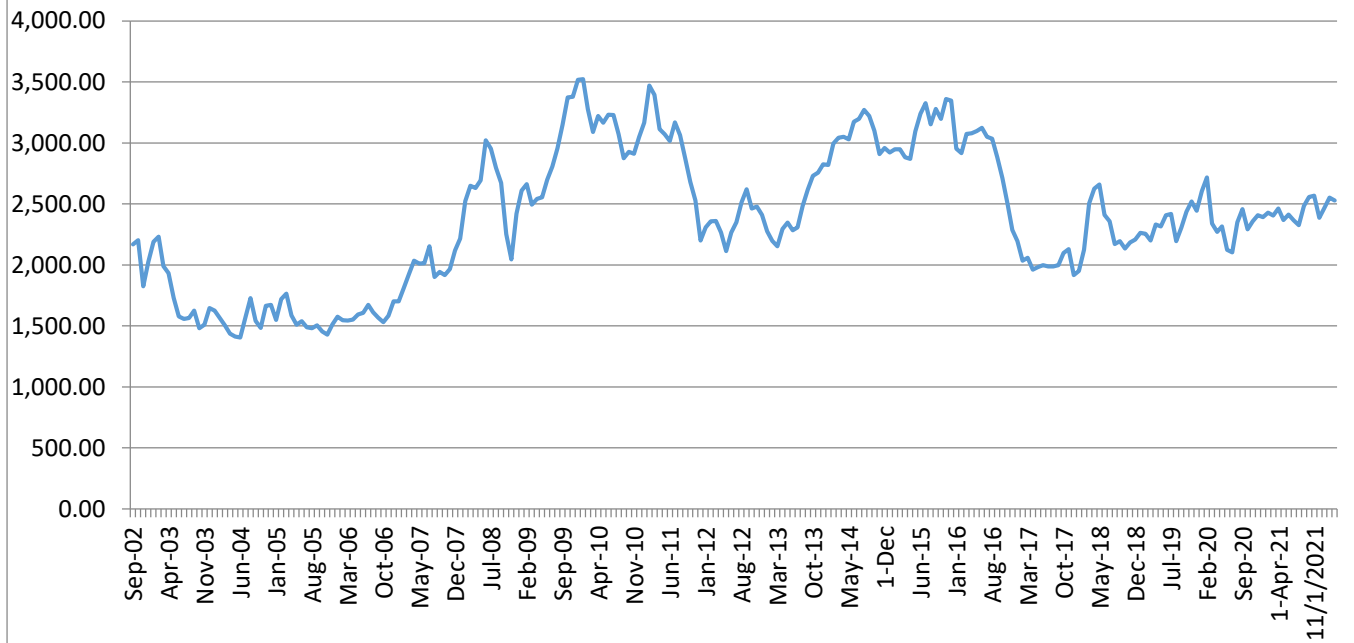


**Rubber - Monthly Price - No 3 smoked sheet Sing.
USD/kg (1988-Apr 2022)**

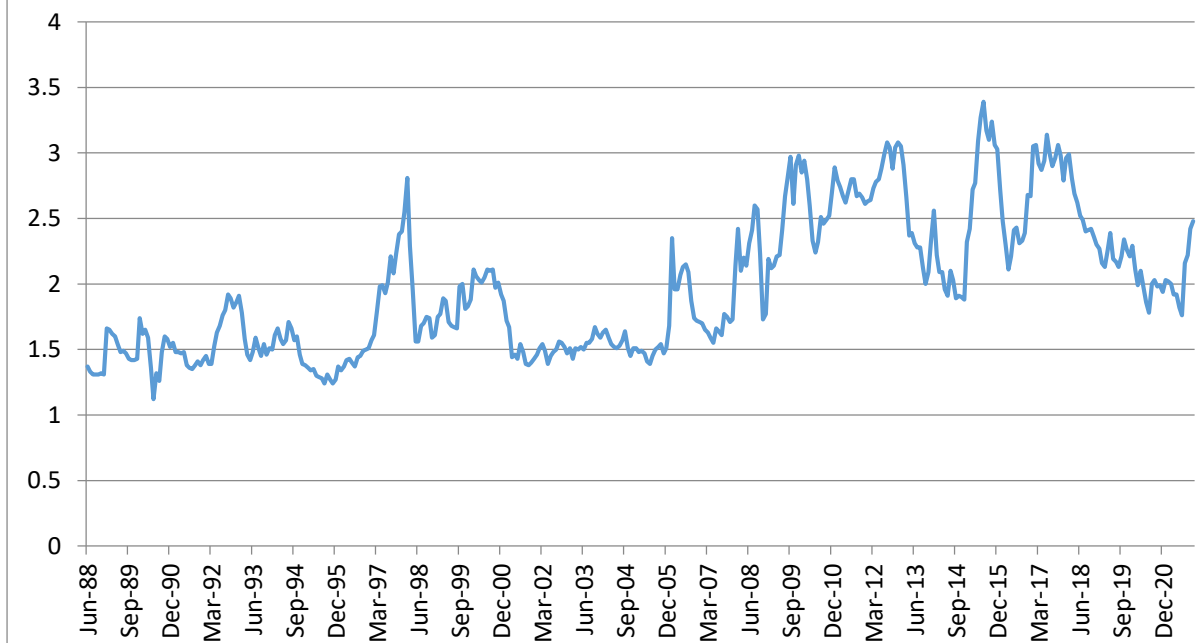


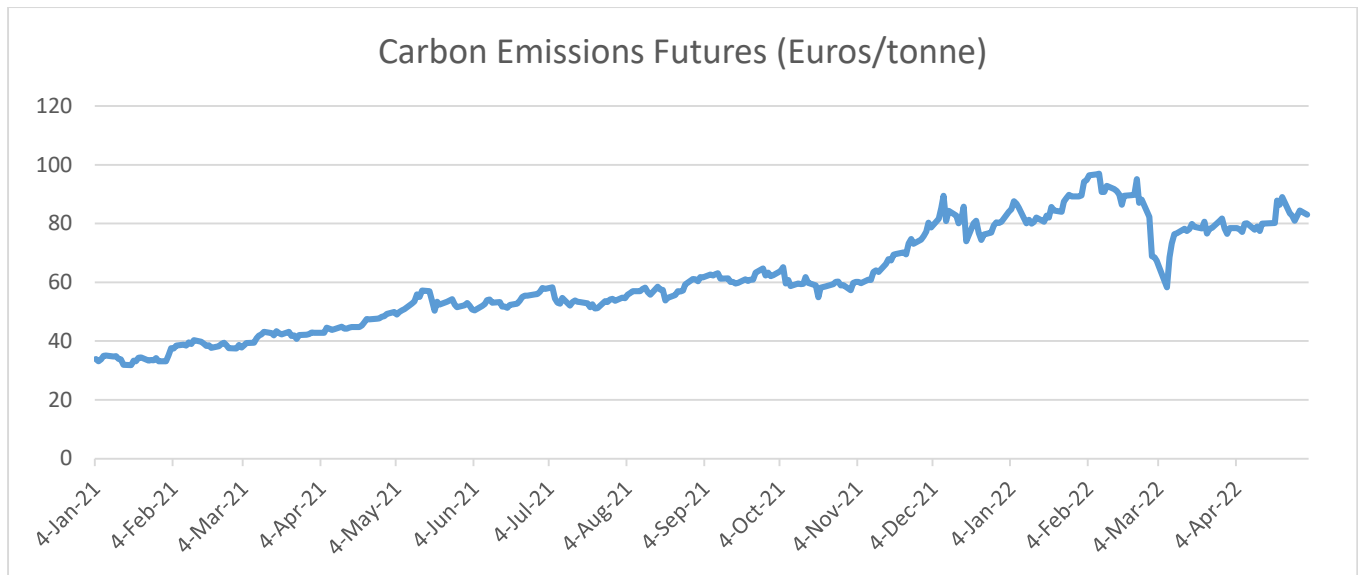


International Cocoa Price (ICCO) USD/tonne Jan 2002 - 10 Mar 2022

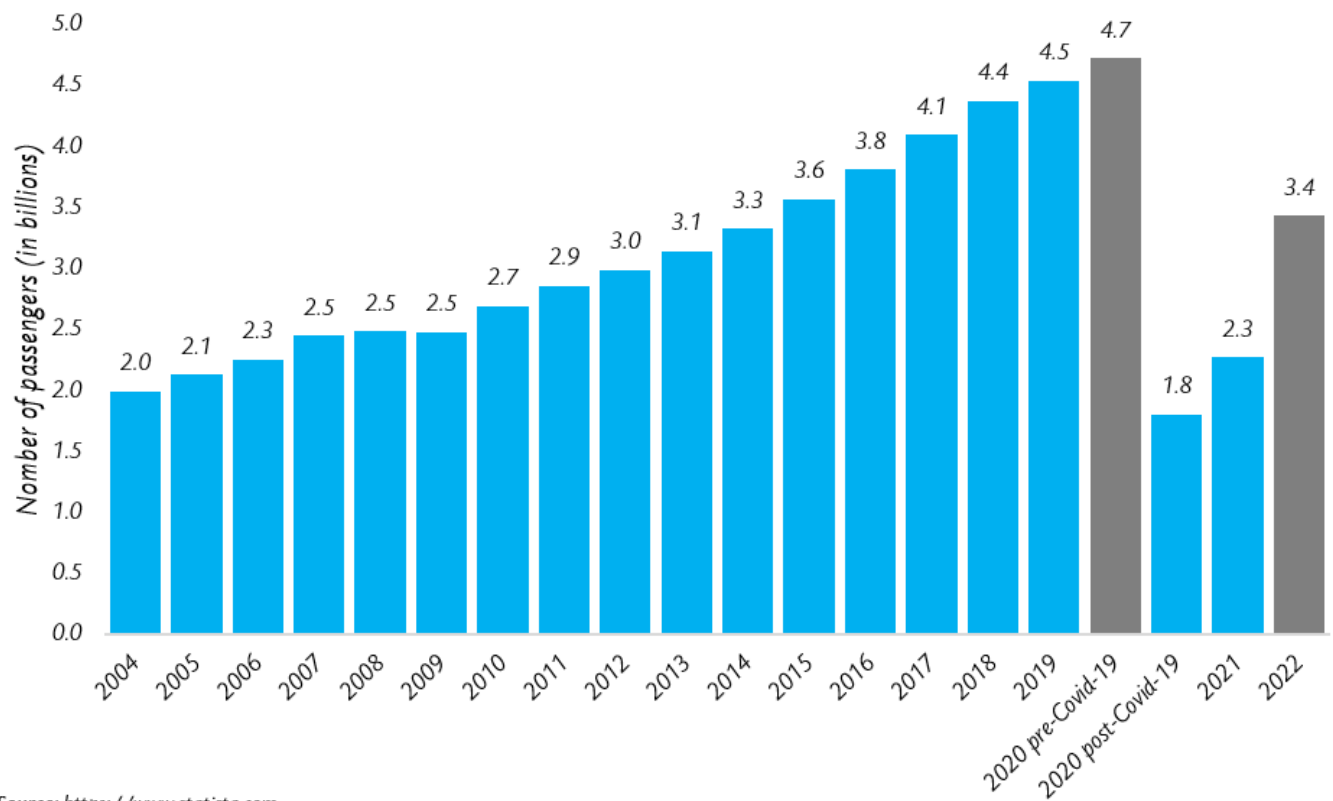


Tea Prices USD/Kgs 1988-Nov 2021





Scheduled Passengers Boarded by Scheduled Airlines



Source: <https://www.statista.com>