2020 Budget Strategy Paper

Presented by

Hon. Ian Ling-Stuckey, CMG, MP.

Treasurer

27th November, 2019

Contents

Government of Papua New Guinea
2020 Budget Strategy Paper

I. PURPOSE

The publication of the Budget Strategy Paper (BSP) is in compliance with the *Papua New Guinea Fiscal Responsibility Act (FRA) 2006*. It is a key component of the Government of PNG's (GoPNG) budget reform agenda which aims to improve the preparation of budgets, provide for efficient management of public finances and further promote transparency and accountability.

The 2020 BSP provides the public with the fiscal framework context in which the 2020 Budget will be designed. The 2020 BSP is the first being produced under the newly formed Government led by Prime Minister, Hon. James Marape and the Deputy Prime Minister and Minister for Justice and Attorney General, Hon. Davis Steven. This BSP is drawn from the high-level policy direction of the Treasurer, Hon. Ian Ling Stuckey, CMG.MP, after completing his Due Diligence exercise on taking stock of Government finances as well as introducing the 2019 Supplementary Budget on the 11th October, 2019. The finalisation of this Budget Strategy Paper has been delayed as there was a requirement for an extensive due diligence exercise to correct earlier estimates.

This 2020 Budget Strategy is not just about forming the framework for the 2020 Budget. As the planning horizon is over five years, it becomes the government's new *Medium Term Fiscal Strategy (MTFS) 2020-2024*. Key targets are provided for total revenues, total expenditures including targets for both the operational and capital budgets, the program for reducing deficits from 2020 onwards, and the financing of debt levels. Major adjustments have been required as the starting point was found to be so different than at the time of the 2019 budget.

At the time of the 2019 Budget, the deficit was estimated to be K1,866 million and the debt to Gross Domestic Product (GDP) ratio at 32 per cent. After the completion of the due diligence work, and after further work on clarifying known arrears, the revised starting point in September was a deficit of K4,936 million and a debt to GDP ratio of 42 per cent. These are extraordinary revisions. They reveal there has been a need for more honest budgeting. The true economic situation must be known to plan for economic repair and reconstruction.

The framework for the 2020 Budget is to begin this process of repair. It will capture key reforms or measures contained in the Marape-Steven's overarching development strategy underpinned in the Loloata Commitments.

The 2020 BSP has been based on a GDP series that has been revised since the 2019 Mid-Year Economic and Fiscal Outlook (MYEFO), after extensive consultations with the National Statistical Office (NSO), the Bank of PNG (BPNG) and the International Monetary Fund (IMF). All agencies have now agreed on a common methodology and accepted the PNG NSO GDP figures up to 2017, and the Treasury's forward estimates of growth.

Marape-Steven Governments Overarching Development Strategy

The Prime Minister's Manifesto has the theme of taking back Papua New Guinea. This vision is a call to rally the citizenry and development partners to a development path leading to a robust, inclusive and sustainable economy in which PNG citizenry have an increased stake. It rallies the country to build a stable social and political environment underpinned by a changed culture of contribution, service and civility.

The guiding doctrines of development espoused by the Five National Goals and Directive Principles, the National Strategy of Responsible Sustainable Development (StaRS), and Papua New Guineas commitment to the 17 United Nations Sustainable Development Goals, have been captured in the development principles defined by Vision 2050, and Development Strategic Plan 2030, and woven into the prescriptions of MTDPs II and III.

The central message in these plans is for Papua New Guinean citizens to take responsibility of the socio-economic destiny of the country, and reposition and develop it to be a fair and happy society, where no child is left behind. This can be achieved through smartly designed and wisely executed Government intervention programmes.

The Marape-Steven government is cognizant of the intergenerational relevance and value of these development goals. Accordingly, it advanced *the 'LOLOATA COMMITMENT'* as its rescue and reconstruction strategy going forward. It is a two phase strategy that began with a reality check of the fiscal situation of the country. A Due Diligence exercise was undertaken and based on the findings, painful but necessary corrective measures were put in place through the 2019 Supplementary Budget. These corrective measures set the basic building blocks for the 2020 and subsequent Budget Strategies.

There are many important components of the rebuilding programme, under the Loloata Commitment. Key ones will be discussed further in the 2020 Budget, including actions to reform State Owned Enterprises. The Marape-Steven Government considers the SOEs reform programme not only as a key vehicle for delivering improved and cost-effective public services, but a strategy for improving the cost structure of domestic value adding production for improved international trade competitiveness.

The broad objectives of the reconstruction and reform programme under the 2020 Budget Strategy is to provide the platform for fiscal consolidation whilst at the same time continuing with strategic capital formation necessary to continue to enable the private sector and community to grow the economy, in particular the non-resource sector, expand the tax base and strengthen the efficient and cost effective of delivery of essential services.

II. DOMESTIC ECONOMIC OUTLOOK

The framing of the 2020 Budget Strategy is set in a broader economic context and outlook than previous years. This updated economic outlook seeks to combine a better understanding of some key economic variables. The Marape-Steven's Government will concentrate its economic attention on broad-based, inclusive growth. The focus will be on incomes, jobs and better economic management.

Living Standards

Future discussions of PNG's economic outlook will place greater attention on the non-resource sector. This part of the economy has the greatest impact on the livelihoods of most people within the country. For PNG, the best measure of economic livelihoods is the measure of non-resource GDP which also takes into account the impacts of inflation (price increases) and a growing population. This measure is called "real non-resource GDP per capita".

Figure 1 sets out the measure of the "real non-resource GDP per capita" livelihoods indicator from 2007 to 2017, and then estimates through to 2024 based on NSO numbers and Treasury projections. After reasonable growth in the 2000s, which continued through the PNG LNG construction phase, there has been a major slowdown. Average living standards are estimated to have declined by K520 for every person in the country from an average of K5,380 in 2014 down to K4,860 in 2019. There is a slow process of recovery based on current policies to increase growth in the non-resource sector. The new government is committed to lifting the growth rate of the non-resource economy to over 5 per cent per annum.

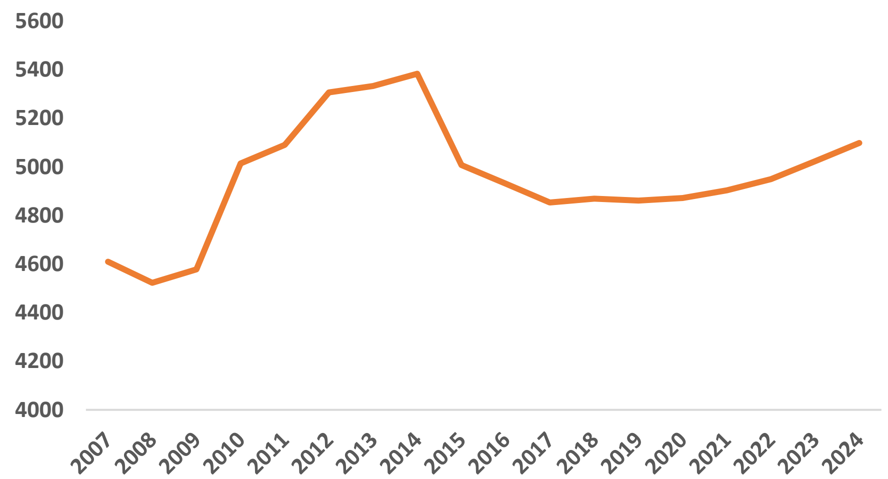


Figure 1 Non-Resource GDP per capita

Jobs

Another key measure of economic performance is jobs. Statistics are only available on formal sector employment. This accounts for only a small proportion of total employment in the economy. Most of PNG's population is employed in the subsistence, cash cropping and other informal sectors. Using the indicator of formal sector jobs, there is a similar pattern of reasonable growth during the 2000s followed by decline in recent years. This is shown in Figure 2.

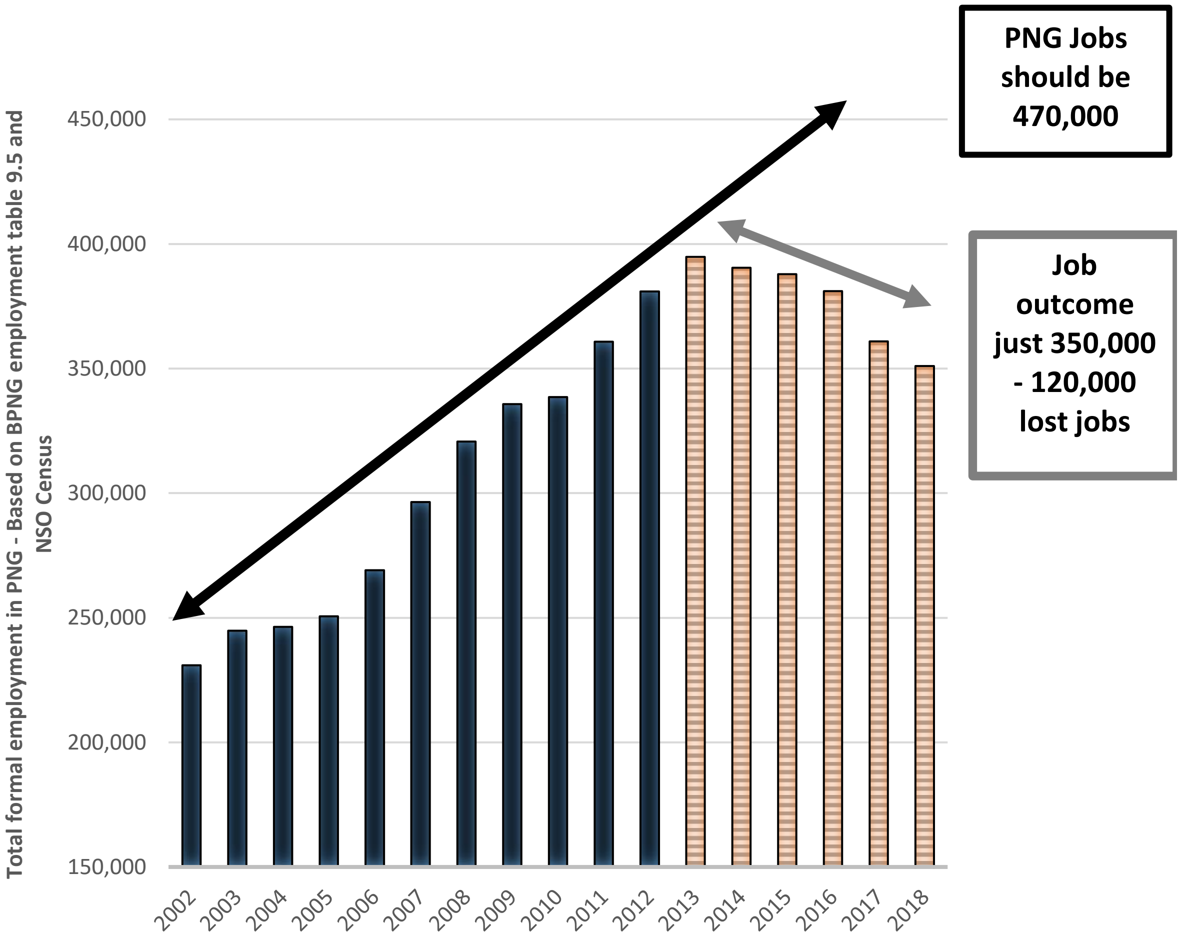


Figure 2 Pattern of Job Growth over time

Formal employment had been growing by over 15,000 jobs annually between 2005 and 2012. From 2013, the growth in jobs has stalled. While an initial drop may have been expected at the end of the construction phase of the PNG LNG project, the fall in job figures has been consistent and even accelerating. PNG has not experienced jobless growth, it has experienced falling jobs growth. By 2018, the gap between former jobs growth and recent jobs declines now represents 120,000 lost jobs. The pattern of PNG's growth is not delivering jobs growth. The new government is committed to lifting jobs growth back to at least 10,000 jobs per annum. This is a conservative estimate. Extra jobs also means extra incomes for families, as well as extra taxes to help pay for basic services.

Economic Management

There are several indicators of economic management performance available from independent agencies. One of these is based on indicators of economic performance by the multilateral development banks. Figure 3 maps out the assessments of PNG's governance performance by the World Bank with inputs from the Asian Development Bank (ADB) – (see https://www.worldbank.org/en/topic/fragilityconflictviolence/brief/harmonized-list-of-fragile-situations). These figures are combined in an index which assesses governance performance. Below a cut-off point in the index (3.2), a state or area is considered a "fragile situation". PNG climbed out of this classification in 2007 following years of economic reform and improvement in economic management. It maintained this rating until 2012, but has been in decline since then according to this measure from the World Bank and ADB. The Marape-Steven's Government is committed to improving PNG's economic governance performance. It will work actively to lift PNG so that it will no longer be regarded as a "fragile situation" country. One benefit of increased honesty and transparency is by admitting to PNG's current economic fragility also opens doors to increased levels of friendly foreign support including very concessional loan facilities within the World Bank IDA19 replenishment process.

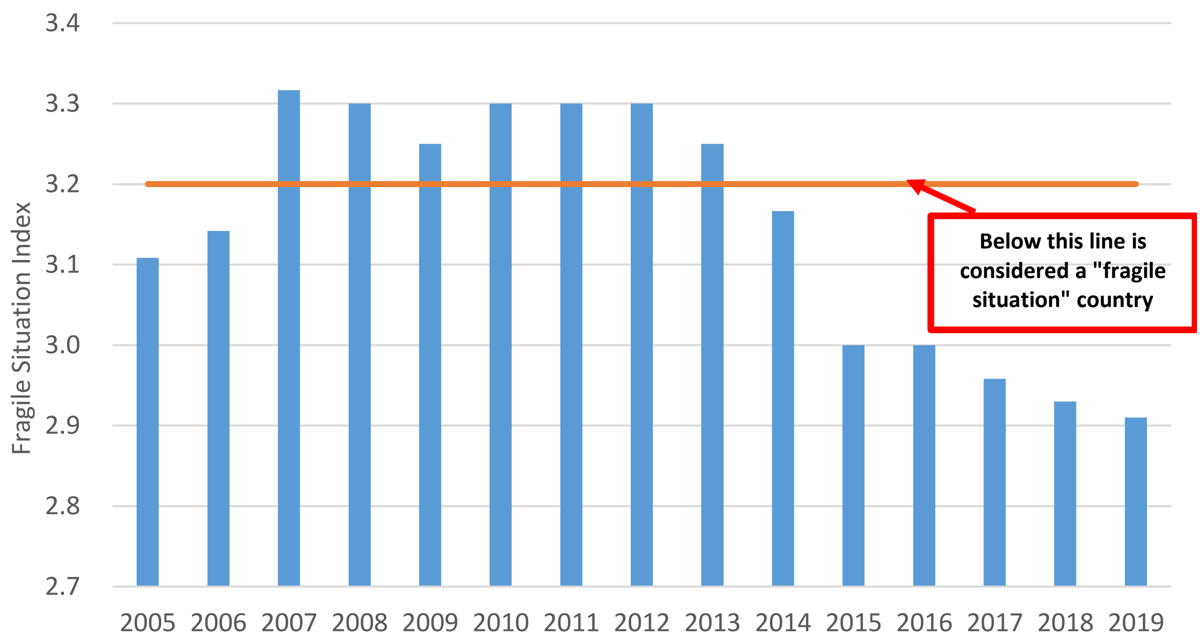


Figure 3 Fragile Situation Index

GDP

In 2018, the PNG economy contracted by 0.8 per cent, down from the 2019 Budget estimate of 0.3 per cent.

In 2019, real growth in the non-resource sector has been revised down to 2.9 per cent in 2019, 0.2 percentage points lower than the 2019 Budget estimate of 3.1 per cent. Growth in the agriculture, forestry and fishery (AFF) sector is projected at 2.5 per cent, 0.3 percentage points lower than the previous year. In addition, the growth forecasting methodology has been revised back to the usual practice of not incorporating the impact of new resource projects until there is a Final Investment Decision.

In 2019, the oil and gas sector is projected to grow sharply at 14.4 per cent rebounding from a contraction of 15.8 per cent in 2018 due to the earthquake. This includes a 14.9 per cent increase in LNG volumes and 11.1 per cent increase in condensate production. LNG production is expected to reach 445.0 Trillion British thermal units (Tbtu) while condensate to reach 11.0 MB in 2019. Mining is expected to expand at 6.0 per cent, 3.7 percentage points lower than the previous year.

In 2019, overall GDP growth is projected in real terms to be 5.0 per cent, 1.0 percentage point higher than the 2019 Budget estimate of 4.0 per cent.

In 2020, real non-resource growth is projected at 3.3 per cent. This reflects the persistent constraints in business condition in the non-mineral sectors due to legacy issues of foreign exchange shortages. Growth in the agriculture, forestry and fishing sector is expected to be 3.4 per cent. The growth in agriculture is driven by the on-season in coffee, increased projected Palm Oil production, and increased cocoa yields from the ongoing revitalization in the cocoa industry. The information and communication sector is expected to grow at 8.0 per cent reflecting better communications access flowing from the Coral Sea cable. This sector is expected to continue its strong growth for the following two years.

In 2020, the oil and gas sector is expected to fall by 4.9 per cent, reflecting underlying declines in gas and oil production with the end of the “rebound” effect in LNG production after the earthquake. Strong growth is projected in the mining and quarrying (M&Q) sector (6.2 per cent) driven by projected increased production in copper (Ok Tedi), gold (Ok Tedi + Porgera while Lihir is flat) and Nickel & Cobalt from Ramu Nico.

The NSO has produced a new GDP measure for 2017. This figure now provides the basis for the fiscal framework set out in this document. Figure 4 shows the revised estimates for GDP, and non-resource GDP.

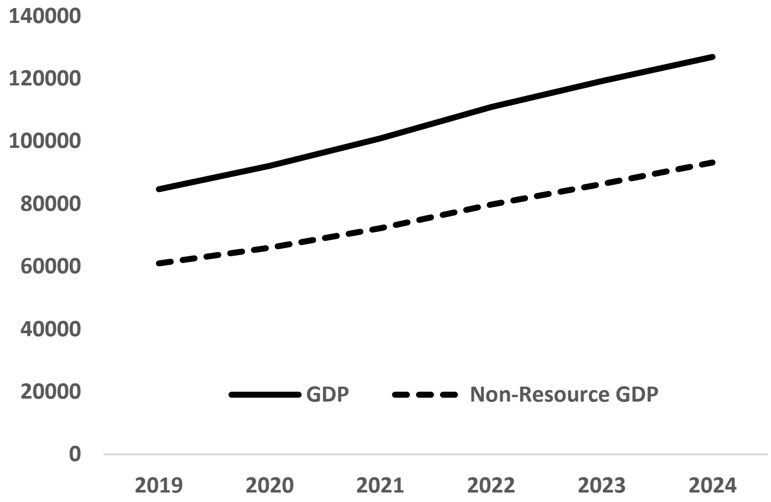


Figure 4 GDP (Kina millions)

Table 1: Economic Parameters (2014-2024)

	2014 Actual	2015 Actual	2016 Actual	2017 Actual	2018 Est	2019 Proj	2020 Proj	2021 Proj	2022 Proj	2023 Proj	2024 Proj
Economic Growth											
Total Real GDP (%)	13.5	9.5	4.1	3.5	-0.8	5.0	2.0	2.8	2.9	3.2	3.3
Non-mining Real GDP (%)	4.1	-4.1	1.5	1.5	3.4	2.9	3.3	3.8	4.1	4.6	4.6
Inflation											
Average on Average (%)	5.2	6.0	6.7	5.4	4.7	4.4	5.7	6.7	6.8	6.5	5.7
Dec on Dec (%)	6.6	6.4	6.6	4.7	4.8	4.4	6.2	6.9	5.3	7.6	5.5
Exchange rate											
Real Exchange Rate Index (2007 = 100)	153.2	141.0	131.0	132.9	131.6	130.7	133.1	136.1	139.9	143.6	143.6
Interest rate											
Kina Rate Facility (KFR)	6.25	6.25	6.25	6.25	6.25	5.50	5.50	5.50	5.50	5.50	5.50
Inscribed Stock (3 year yield)	8.0	9.7	9.7	9.7	9.7	8.3	8.3	8.3	8.3	8.3	8.3
Mineral Prices											
Gold (US$/oz)	1266	1160	1248	1258	1270	1380	1510	1536	1558	1577	1596
Copper (US$/ton)	6864	5502	4865	6166	6517	5989	5849	5900	5946	5983	5994
Oil (Kutubu Crude: US$/barrel)	93	49	44	51	65	58	54	52	51	51	52
LNG (US$ per thousand cubic feet)	12	8	8	9	11	10	10	10	10	10	10
Condensate (US$/barrel)	93	49	44	51	65	58	54	52	51	51	52
Nickel (US$/tonne)	16847	11831	9595	10415	13109	10782	11034	11566	11973	12395	12395
Cobalt (US$/tonne)	30724	29255	25639	55988	72820	22258	23180	24050	24500	25000	25000

Source: Department of Treasury.

III. MEDIUM TERM PROJECTIONS

The 2019 Supplementary Budget revised the Budget appropriations for 2019 under a reduced revenue envelope revealed by the Due Diligence exercise and confirmed by the independent assessment of the International Monetary Fund (IMF). The Supplementary Budget cut Government expenditures in capital and operational expenses and re-appropriated expenditure warrants for Government agencies to pay higher than budgeted Personnel Emoluments (PE) expense, debt servicing costs and reduce Government's arrears. The Supplementary Budget also supported critical capital expenditure items and protected the operational costs of the health and education sector.

Recognizing the dramatically different fiscal starting base following the due diligence work, recognising known built-up arrears, and moving to international standards for measuring debt, the debt to GDP ratio would have moved to 42 per cent if no corrective action was taken. There was no scope to reduce this ratio back to the legal limit of 35 per cent of GDP within the last two months of the year – it would have required no government expenditures for the last two months of the year as well as massive increases in taxes.

Instead, a significant fiscal adjustment was made in the Supplementary Budget. A medium-term strategy for repair was set out and is incorporated in this 2020 Budget Strategy which is now the Medium-Term Fiscal Strategy. In addition, there was a need to amend the FRA to recognise that the debt to GDP ratio exceeded the current legal limits. The debt anchor has been adjusted with an upper limit of 45 per cent of GDP for the first 5 years on the commencement of the amended 2019 FRA, to 40 per cent of GDP by 2024 and down to 35 per cent after 10 years.

The 2020 Budget is a product of national priorities to improve Government budgeting, protect expenditure in social security programs, boost capital public investment by expanding use of concessional financing and clearing contractual obligations to the private sector to boost the economy. The Government is also intent on controlling expenditure in PE for the civil service which has grown considerably due to policies under previous administrations.

Table 2. Summary Medium Term Framework

	2019 Pre-Cuts	2019 Supplementary	2020 Budget	2021 Projection	2022 Projection	2023 Projection	2024 Projection
Revenues and Grants	13,022.4	13,022.4	13,905.5	14,968.1	16,364.9	17,625.4	18,731.1
Expenditure (excluding arrears provision)	17,317.2	15,885.2	17,484.5	17,807.5	18,790.2	19,867.1	21,126.6
Net Lending/Borrowing (Deficit)	(4,294.8)	(2,862.8)	(3,579.0)	(2,839.4)	(2,425.3)	(2,241.7)	(2,395.5)
%GDP	-5.1%	-3.4%	-3.9%	-2.8%	-2.2%	-1.9%	-1.9%
Expenditure (including arrears provision)	17,958.2	16,526.2	18,536.5	18,737.5	18,790.2	19,867.1	21,126.6
Net Lending/Borrowing (Deficit)	(4,935.8)	(3,503.8)	(4,631.0)	(3,769.4)	(2,425.3)	(2,241.7)	(2,395.5)
%GDP	-5.8%	-4.1%	-5.0%	-3.7%	-2.2%	-1.9%	-1.9%
Debt/GDP	42%	41%	41%	41%	39%	38%	38%

Source: Department of Treasury

Table 3. Summary 2020 Budget Strategy and medium term fiscal framework

	2020 Budget	2021 Projection	2022 Projection	2023 Projection	2024 Projection
Budget Deficit Cash (%GDP)	-5.0%	-3.7%	-2.2%	-1.9%	-1.9%
Expenditure Rule (Operating Budget less interest /Non-Resource GDP)	16.0%	13.9%	12.0%	11.2%	10.6%
Debt (%GDP)[1]	41%	41%	39%	38%	38%
Budget Deficit FRA Calculation[2]	-5.4%	-3.9%	-2.1%	-1.3%	-1.0%

1/ After deficit and GDP impact and including outstanding arrears

2/ Non-Resource Primary Balance excluding Project Financing as a share of non-resource GDP

Source: Department of Treasury

The medium-term fiscal strategy up to 2024 targets a reduction in the debt to GDP ratio from 41 per cent in 2020 to 38 per cent in 2024. This complies with the amended FRA and the limit of 40 per cent by 2024. The target debt to GDP ratio of 38 per cent provides a 2 per cent cushion against unprogrammed slippage and shocks.

In addition to the debt to GDP target, the Government will target a new Expenditure Rule to reduce the operating budget as a portion of non-resource GDP. Targets are that this ratio will fall from 16.0 per cent in 2020 to 10.6 per cent by 2024. This rule is intended to complement the path of fiscal adjustment across the medium term by directing more resources to capital investment.

Finally, a new budget deficit measure in the FRA will target the non-resource primary balance excluding multilateral concessional project financing, which is anticipated to reorient incentives toward more concessional finance over the medium term within declining debt ratios. This budget deficit target based on the FRA is targeted to fall from 5.4 per cent in 2020 to 1.0 per cent in 2024.

Table 4. Detailed Overall Framework (Kina million)

	2019 Supplementary	2020 Budget	2021 Projection	2022 Projection	2023 Projection	2024 Projection
Total Revenue	**13,022.4**	**13,905.5**	**14,968.1**	**16,364.9**	**17,625.4**	**18,731.1**
Tax Revenue	10,447.9	11,241.6	12,010.1	13,297.5	14,524.2	15,502.2
Grants	943.1	932.1	1,008.3	1,092.7	1,076.6	1,145.8
Other Revenue	1,631.4	1,731.8	1,949.7	1,974.7	2,024.7	2,083.1
Total Expenditure	**16,526.2**	**18,536.5**	**18,737.5**	**18,790.2**	**19,867.1**	**21,126.6**
Total Expenditure (excluding arrears provision)	**15,885.2**	**17,484.5**	**17,807.5**	**18,790.2**	**19,867.1**	**21,126.6**
Operating Budget	11,811.2	12,742.0	12,273.7	11,871.8	12,207.5	12,542.0
Capital Budget	4,715.0	5,794.5	6,463.8	6,918.4	7,659.6	8,584.6
Overall Balance	**(3,503.8)**	**(4,631.0)**	**(3,769.3)**	**(2,425.3)**	**(2,241.7)**	**(2,395.4)**

The operating budget over the medium term will be reduced to 9.9 per cent from 14 per cent, including debt service of GDP; while the capital budget will be expanded to 6.8 per cent, from 5.6 per cent under the 2019 Supplementary Budget. This will be accomplished in part through a greater drawdown of concessional capital funding tied to projects.

Table 5. Detailed Overall Framework (% GDP)

	2019 Supplementary	2020 Budget	2021 Projection	2022 Projection	2023 Projection	2024 Projection
Total Revenue	**15.4%**	**15.1%**	**14.8%**	**14.8%**	**14.8%**	**14.8%**
Tax Revenue	12.3%	12.2%	11.9%	12.0%	12.2%	12.2%
Grants	1.1%	1.0%	1.0%	1.0%	0.9%	0.9%
Other Revenue	1.9%	1.9%	1.9%	1.8%	1.7%	1.6%
Total Expenditure	**19.5%**	**20.1%**	**18.6%**	**17.0%**	**16.7%**	**16.6%**
Total Expenditure (excluding arrears provision)	**18.8%**	**19.0%**	**17.6%**	**17.0%**	**16.7%**	**16.6%**
Operating Budget	14.0%	13.8%	12.2%	10.7%	10.2%	9.9%
Capital Budget	5.6%	6.3%	6.4%	6.2%	6.4%	6.8%
Overall Balance	**-4.1%**	**-5.0%**	**-3.7%**	**-2.2%**	**-1.9%**	**-1.9%**

Source: Department of Treasury. Note that this table is entirely based on figures being a share of GDP. For the expenditure rule, the target is expressed as a share of non-resource GDP and excludes interest costs. This explains the differences in percentages.

N.B. Arrears are appropriated under code 207, but are split in these reporting tables between operating (K200m) and capital (K300m) reflecting where they will be expended.

Tables 6 and 7 below shows the anticipated path of revenue and expenditure in the budget, and the required financing resources. The Government will tightly control operating expenditure in order to support the expansion of the capital budget. The one-off payments of arrears in 2020 and 2021, particularly in PE, utilities and rentals should reduce the ratio as a share of non-resource GDP beyond 2022.

Table 6. Government Revenue over the Medium-Term (Kina, Million)

	2019 Supplementary	2020 Budget	2021 Projection	2022 Projection	2023 Projection	2024 Projection
TOTAL REVENUE AND GRANTS	**13,022.4**	**13,905.5**	**14,968.1**	**16,364.9**	**17,625.4**	**18,731.1**
Tax Revenue	**10,447.9**	**11,241.6**	**12,010.1**	**13,297.5**	**14,524.2**	**15,502.2**
Taxes on Income, Profits and Capital Gains	5,983.6	6,421.9	7,033.8	7,713.4	8,381.4	8,984.4
Taxes on Payroll and Workforce	1.6	-	-	-	-	-
Taxes on Goods and Services	3,693.0	4,016.2	4,097.6	4,664.0	5,301.8	5,642.7
Taxes on International Trade and Transactions	769.6	803.5	878.7	920.1	841.0	875.1
Grants	**943.1**	**932.1**	**1,008.3**	**1,092.7**	**1,076.6**	**1,145.8**
Other Revenue	**1,631.4**	**1,731.8**	**1,949.7**	**1,974.7**	**2,024.7**	**2,083.1**

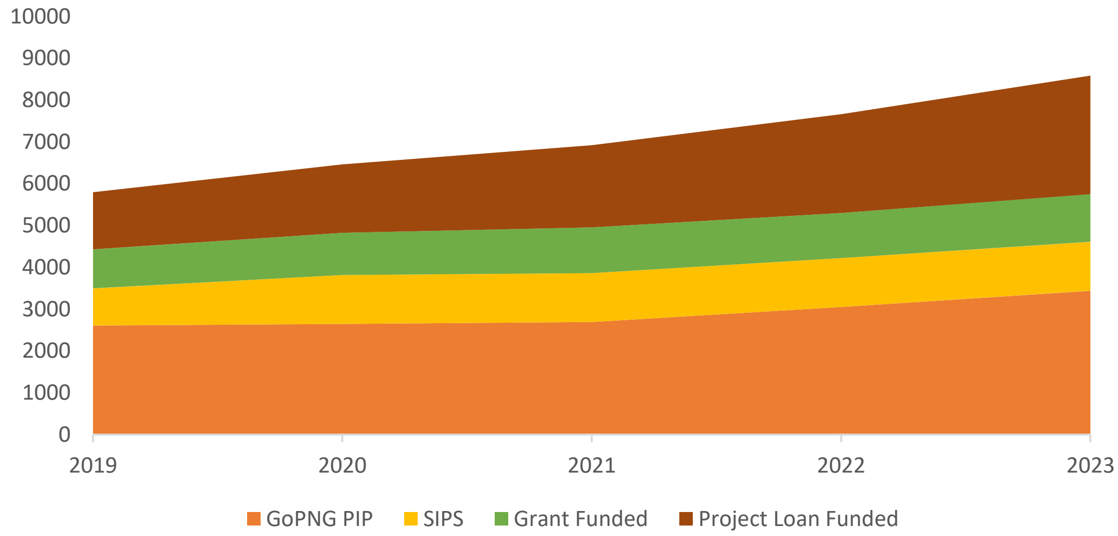
Source: Department of Treasury

Tax revenue is expected to grow in line with GDP, at around 12 per cent to 12.3 per cent over the medium term, with some potential upside as revenue reforms are progressed by the Internal Revenue Commission (IRC) and PNG Customs Service (PNGCS). Similarly, Grants (gift aid from other countries) are also projected to increase in line with GDP over the same period, while Other Revenues (mainly dividends and transfers from other agencies) will hinge upon reforms to dividend payments being implemented, and the continued performance of the *Public Money Management Regularisation (PMMR) Act* in drawing revenues from collecting agencies.

Expenditure

Total Expenditure is driven in part over the next few years by the repayment of arrears accrued in recent past years, with the profile expected to be revised depending on the identification of additional arrears, and the validation process the Government will undertake to ensure that arrears are legitimate. The underlying capital budget supported by donor loans is anticipated to grow by 20 per cent per annum, driven by greater drawdowns on committed funds from partners. Partners already have approved K6.9 billion in loan funded projects ready to be drawn down, and this gives the Government significant scope to expand capital. The GoPNG capital budget will grow at an underlying rate of 10 per cent each year in the medium term, supported by savings through the operating budget.

Figure 5: GoPNG Capital Expenditure Path



Source: Department of Treasury

Table 7. Government Expenditure over the Medium-Term (Kina, Million)

	2019 Pre-Cuts	2019 Supplementary	2020 Budget	2021 Projection	2022 Projection	2023 Projection	2024 Projection
TOTAL EXPENDITURE (including arrears provision)	**17658.2**	**16526.2**	**18536.5**	**18737.5**	**18790.2**	**19867.1**	**21126.6**
TOTAL EXPENDITURE (excluding arrears provision)	**17017.2**	**15885.2**	**17484.5**	**17807.5**	**18790.2**	**19867.1**	**21126.6**
Operating Budget	**11890.2**	**11811.2**	**12742.0**	**12273.7**	**11871.8**	**12207.5**	**12542.0**
Personnel Emoluments	5379.1	5379.1	5916.8	5874.0	5524.0	5733.9	5944.7
Debt Service	2101.5	2101.5	2206.9	2205.0	2289.3	2499.6	2622.4
Other Operating	4409.6	4330.6	4618.3	4194.8	4058.5	3974.1	3974.9
Capital Budget/PIP	**5768.0**	**4715.0**	**5794.5**	**6463.8**	**6918.4**	**7659.6**	**8584.6**
GoPNG Funded	4007.9	2954.9	3497.4	3817.5	3860.1	4224.3	4608.3
Grant Funded	943.1	943.1	932.1	1008.3	1092.7	1076.6	1145.8
Loan Funded	817	817.0	1365.0	1638.0	1965.6	2358.7	2830.5

Source: Department of Treasury

N.B. Arrears are appropriated under code 207, but are split here between operating (K200m) and capital (K300m) reflecting where they will be expended.

PE will be controlled and managed over time through the payment of exit arrears allowing staff to begin leaving the payroll, and through restrictions on entry to the payroll in recent growth areas through hard budgetary ceilings. In addition, the Government will clear the 3 per cent pay rise arrears which will provide an effective increase in take-home pay while simultaneously holding off further wages/salary negotiations for a year while monitoring the economic and financial situation. The Government will undertake an independent review targeted at ensuring the integrity of the payroll and removal of ghost workers. This will establish an accurate baseline for PE expenditure going forward. CEOs of all departments and agencies will have 'living within their means' as a core Key Performance Indicator (KPI). Under the new government, failure to meet this core KPI will mean termination. Continued over-expenditure and building up of arrears is not a pathway forward. Leadership accountability is vital.

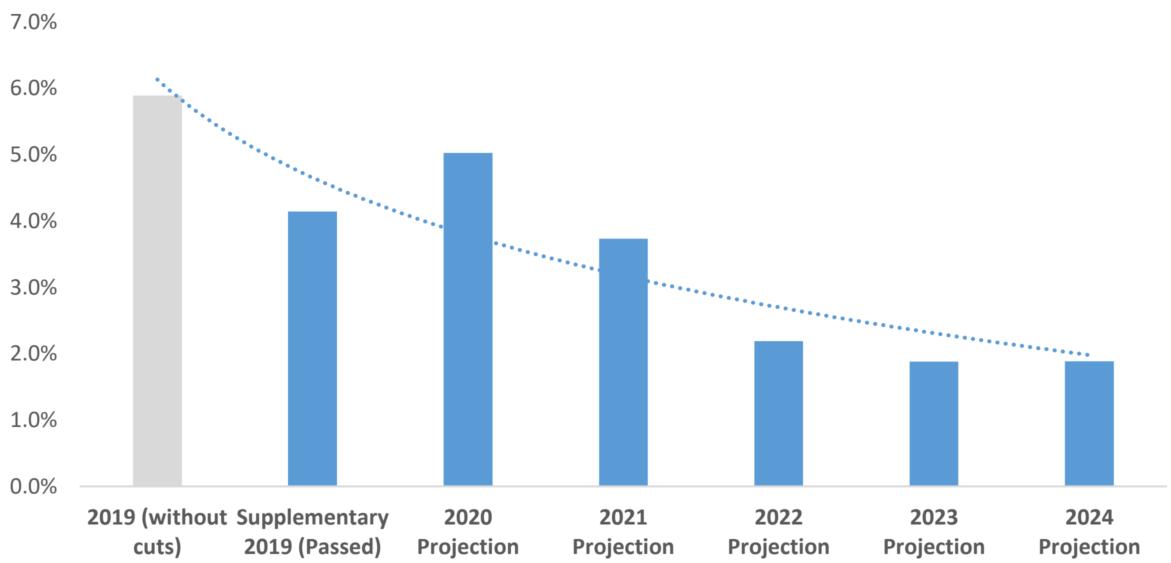
Table 8. Deficit (Kina, Million)

	2019 Pre-Cuts	2019 Supplementary	2020 Budget	2021 Projection	2022 Projection	2023 Projection	2024 Projection
Overall Balance (Cash Deficit)	(4,935.8)	(3,503.8)	(4,631.0)	(3,769.4)	(2,425.3)	(2,241.7)	(2,395.5)
%GDP	-5.8%	-4.1%	-5.0%	-3.7%	-2.2%	-1.9%	-1.9%
Primary Balance (excludes interest costs)	(2,834.3)	(1,402.3)	(2,424.1)	(1,564.4)	(136.0)	257.9	226.9
%GDP	-3.4%	-1.7%	-2.6%	-1.5%	-0.1%	0.2%	0.2%
Non-Resource Primary Balance (no interest & resource revenues)	(6,717.8)	(2,918.1)	(6,310.5)	(5,575.9)	(4,286.8)	(3,942.5)	(4,111.2)
% Non-Resource GDP	-11.0%	-3.4%	-6.8%	-5.5%	-3.9%	-3.3%	-3.2%

Source: Department of Treasury

The overall cash budget deficit is expected to rise to 5 per cent in 2020, primarily reflecting the one-off pay-down of arrears and the expansion of capital expenditure from concessional loan drawdowns. This will be reduced significantly over the medium term, showing a continued pattern of improvement. Figure 6 also demonstrates the impact of the savings put in place in 2019. A reassessment of the 2019 Budget determined substantial arrears and a further overrun in payroll that needed to be addressed. In order to do this, the 2019 Supplementary Budget appropriated greater funds for arrears and salary overruns, as well as overruns in rentals and utilities; and paid for this through reductions across capital, operations and the Service Improvement Programs (SIPs).

Figure 6: Cash Deficit over the Medium Term (% GDP)



Source: Department of Treasury

Financing

Given the programmed deficit, the Government's debt to GDP ratio is estimated to be 41 per cent including arrears in 2020 and below the Fiscal Responsibly Act (Amended 2019) (FRA) threshold of 45 per cent. From 2020, the Government will work towards acquiring more concessional loans, including exploring options for guarantees to reduce the costs of debt, and will continue the move towards longer duration domestic debt (see Annex 1 for more details on the flows and revaluation of debt).

Table 9. Financing (Kina, Million)

	2019 Budget	2019 Supp. Budget	2020 BSP	2021 Projection	2022 Projection	2023 Projection	2024 Projection
Net Financing	**1,866.7**	**1,047.2**	**4,631.0**	**3,769.4**	**2,425.3**	**2,241.7**	**2,395.5**
Net Assets	**-**	**(1,228.6)**	**-**	**-**	**-**	**-**	**-**
Net Liabilities	**1,866.7**	**2,275.8**	**4,631.0**	**3,769.4**	**2,425.3**	**2,241.7**	**2,395.5**
Domestic Net Financing	**(629.4)**	**574.9**	**994.1**	**630.8**	**1,120.6**	**660.2**	**362.3**
Treasury Bills	(329.4)	677.9	328.4	316.7	336.2	198.1	108.7
Inscribed Stock	(300.0)	-	766.2	739.1	784.4	462.1	253.6
Loans	-	(103.0)	(100.5)	(425.0)	-	-	-
External Net Financing	**2,496.1**	**1,700.9**	**3,636.9**	**3,138.6**	**1,304.7**	**1,581.5**	**2,033.2**
Debt Securities (sovereign bond)	640.0	-	-	-	-	-	-
Concessional Loans	464.8	464.6	992.0	1,208.5	1,401.4	1,674.7	2,098.5
Commercial	(36.3)	(36.3)	(132.0)	(138.4)	(56.2)	(57.5)	(20.7)
Extraordinary	1,427.6	1,272.6	2,776.9	2,068.5	(40.5)	(35.7)	(44.6)
Total Debt Stock (excluding arrears)	**28,848**	**32,536**	**37,167**	**40,936**	**43,361**	**45,603**	**47,998**
% of GDP	**36%**	**38%**	**40%**	**41%**	**39%**	**38%**	**38%**
Total Debt Stock (including arrears)		**34,518**	**38,097**	**40,936**	**43,361**	**45,603**	**47,998**
% of GDP		**41%**	**41%**	**41%**	**39%**	**38%**	**38%**

Source: Department of Treasury

IV. 2020 BUDGET STRATEGY

As well as the medium term fiscal strategy, and revenue and debt strategies, the Government will build the budget around a set of key principles including:

- spend the money we have more wisely,
- raise the revenues more fairly,
- finance the debt more cheaply,
- leverage friendly international support more intelligently,
- focus on growth in the agriculture sector, SMEs and the informal economy,
- distribute resource benefits more equitably.
- stimulate non-resource growth back to 5 per cent annually,
- comprehensive Government SOE reform program
- freeing up foreign exchange
- create at least 10,000 jobs annually.

Fiscal Strategy

The 2020 Budget Strategy is framed in line with the medium targets and policy objectives of gradual fiscal consolidation commencing in the 2020 Budget after taking stock of the current fiscal situation. The Government will continue from the basis of its 2019 Supplementary Budget in reducing arrears, strengthening the payroll budget, finding efficiencies in operating expenditure and expanding public investment.

In this regard, the deficit target for 2020 is 5 per cent of GDP while the resulting debt to GDP ratio will be 41 per cent including arrears. The expansion in the deficit is predominately the result of one-off payments for reductions in arrears in payroll and other contractual obligations of the Government estimated at K1.05 billion in 2020[1].

However, the overall 2020 BSP has been made on the basis of consolidation in underlying or core spending for the current year in personnel emoluments, SIPs and goods and services. Without including the one-off arrears, the fiscal deficit target for 2020 is 3.9 per cent.

Revenue Strategy and Forecasts

The Government will ensure provision of adequate resources to drive the revised revenue reforms, including ensuring the operations of the Revenue Reform Steering Committee. Successful implementation of the revised revenue strategy is crucial to the medium-term objectives of greater capital spending within an improved debt trajectory. In addition, the Government is working to improve revenue analytics and estimation to support improved budgeting in line with available planned resources.

The expected gains in 2020 from the revised revenue strategy are not expected to be substantial because of the time required to progress some of the key tax

[1] Further arrears will be drawn down in 2021

administration reforms. However, significant gains are anticipated in the medium term with majority of the reforms earmarked for completion in 2020 and 2021.

The revenue projection for 2020 is K13.9 billion based on conservative growth estimates of non-resource GDP. The fall in prices for commodities expected in 2020 means revenue from resources is likely to remain modest. The Government is focusing its 2020 efforts largely in recovering greater revenues from dividends.

Expenditure Rules and Guidelines

The Government's expenditure strategy is focused on controlling operating expenditure to promote growth in capital expenditure, helping reduce the investment deficit and generate non-resource growth. The Government will utilise available donor funds for capital spending in order to promote greater development, while ensuring the protection of crucial social spending across health, education and law and order.

The Government intends to control personnel emoluments' spending through an ongoing effort to address areas of overrun and un-monitored expenditures.

The Government is equally cognizant of maintaining macroeconomic stability and will therefore continue to address underlying structural issues that are likely to undermine investments in social and economic development.

Finally, the Government is committing to a substantial pay down in the level of arrears. From 2020, it is intended that all arrears will be addressed through a process of verification and identification. The Government will find and measure the total stock of arrears under different ministries and expenditure areas, and will ensure these are verified and paid out only on legitimate, provable arrears.

Monitoring & Evaluation

The Government is committed to increasing capital investment to support economic growth. To ensure allocated resources are targeted effectively, a strong and effective Monitoring and Evaluation (M&E) framework is essential. Rigorous monitoring and evaluation are essential to monitor the delivery of capital projects and to ensure the realisation of intended outcomes. A concentrated monitoring and evaluation process also forms part of the Government's risk mitigation strategy and enhances the potential return on investment.

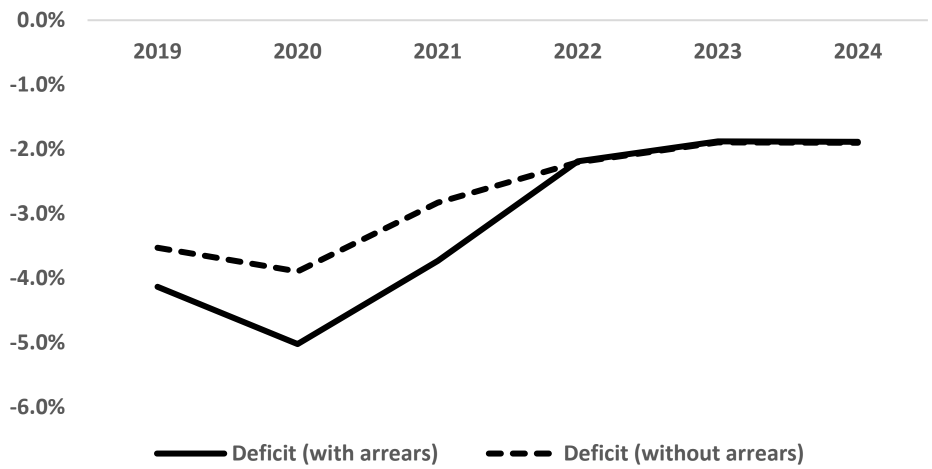
Responsibility for the monitoring & evaluation of Government investment through the Capital Investment Budget primarily resides with the Department of National Planning & Monitoring (DNPM) through individual Project Steering Committees (PSCs) that oversee each project. The PSCs provide support and guidance, and monitors the progress of each project and approves the release of funding for the project, contingent on performance.

Reports from the PSCs will form the basis of quarterly reports provided by DNPM to the Central Agencies Coordinating Committee (CACC) and the

Strategic Budget Committee (SBC). After consideration, these reports should inform the Budget Strategy Paper for the following year.

These measures will not only inform the delivery of outcomes for the current budget but also ensure continuity in funding for specific investments and a more efficient and results-oriented budget over the medium term.

Figure 7: Deficit with and without arrears (% GDP)



Source: Department of Treasury

The medium-term projections incorporate a significant amount of arrears payment, amounting to an estimated K1.05 billion in 2020. This will include arrears under personnel emoluments of K430 million for exit payments; and K122.0 million for the 3 per cent pay increase for 2019. The K200.0 million will be set aside to reduce the Goods and Services arrears in a sensible and cautious manner, and the Government will introduce a process within Treasury to validate and clear these arrears.

Clearance of arrears will involve a process of validating the invoices presented by firms, ensuring there is sufficient documentation to demonstrate (a) the invoice was submitted; (b) there was an authorisation to spend for the invoice – i.e. a warrant and appropriation; (c) there was no, or not sufficient payment, made historically against the invoice and (d) that the work was actually completed. This presents substantial difficulties, as arrears will need to be validated over multiple years. See Table 10 below.

Table 10. Payments of Domestic Arrears (Kina, Million)

	2019 Supplementary	2020 Budget	2021 Projection	2022 Projection	2023 Projection	2024 Projection
Estimated Arrears Payment	641	1052	930	0	0	0
Personnel Emoluments	120	552	430	0	0	0
G+S	200	200	200	0	0	0
Capital	321	300	300	0	0	0

Source: Department of Treasury

Finally, K300.0 million will be set aside to reduce the arrears stock under the capital budget. Arrears payments will continue through to 2021 (see Table 10), clearing a total of an estimated K2.6 billion in arrears in the next two years. However, this figure will be adjusted depending on the results of the validation and identification process.

Debt Strategy

The government will finance the 2020 deficit of K4,630.9 million from a number of sources, targeted towards expanding cheap, external financing. In particular we will work towards:

- Securing commercial finance, supported by a guarantee facility in order to reduce the interest costs;
- Securing financing from friendly foreign sources such as the Australian loan facility provided in 2019;
- Expansion of the long term domestic borrowing, and a move towards utilising the domestic market to a greater extent. This will be supported by efforts to expand the accessibility of the local securities market to overseas investors; and
- Utilisation of the concessional budget support loans from the World Bank and ADB

As per the amendment of the definition of debt in the FRA, the Government has made adjustments to the stock of public and central government debt by adding elements that were previously excluded from the calculation. This includes:

- Incorporating the Motu-Kea, Solwara, and NCD roads debts into the central government debt stock, recognising the Government's guarantee and payments of loans
- Making adjustments to account for some prior disbursements on EXIM Bank of China and Ceska debt
- Adjusting the valuation of debt to a market basis
- Recognition of arrears as part of debt, on an estimated basis, as part of a memorandum report table

These changes will necessitate a set of additional reporting, including tables of valuation changes, other flows and arrears movements in order to ensure full transparency and accuracy.

V. RISKS TO THE ECONOMIC AND FISCAL OUTLOOK

Macroeconomic risks to the PNG Economic and Fiscal Outlook include:

- Continuation of trade tensions between the US and China, coupled with ongoing Middle-East tensions and sharp downward revisions to the global growth outlook will adversely affect the PNG domestic economy through commodity price instability, exchange rate instability, higher imported inflation, higher external financing costs and reduced capital inflow;.

- Continuation of the foreign exchange imbalance poses a considerable risk to domestic economic activity and the inflation outlook, reducing domestic investment and increasing sovereign risk;

- Natural phenomena such as earthquakes, volcanic eruptions, and weather-related issues, disease outbreaks, landowner issues and other events can substantially affect output and distort government revenue and expenditures; and

- Delay in implementation of large extractive investment projects will also impact on overall economic growth, business sentiment and anticipated revenue growth.

Fiscal risks to the PNG economy include:

- Failure to secure the external financing in 2020 including the budget support loans will pose additional pressure on our financing capacities considering the challenging domestic securities markets;

- Failure to secure the projected dividend collections and the higher projected revenues from tax compliance will reduce receipts and place pressure on cash flows;

- SOE debt remains a potential risk, especially that which is explicitly guaranteed by the State. The government will continue to monitor and record public sector debt;

- Previous efforts to reduce exit payment arrears have been slow, despite available appropriations. The increase this year presents a risk to execution if substantial efforts are not made to increase retirement rates; and

- Other risks including higher than programmed recurrent expenditures such as PE, interest payments, utilities and rentals. Failure to control these items in 2020 will add further pressure on execution of the capital budget and other operational areas.

Debt Related Risks include:

- Heavier reliance on domestic borrowing could give rise to higher interest costs, the ability to refinance maturing securities and the consequent crowding out of private credit, while greater exposure to shorter term external borrowing increases rollover and exchange rate risks; and

- Downward revision of nominal GDP levels will affect Debt to GDP ratios and expenditure to GDP ratios, undermining the fiscal program.

Mitigation strategies for these different risks will need to underline the 2020 Budget projections.

Annex 1: All flows in debt stock

	2018 Actual	2019 Supplementary	2020 Budget	2021 Budget	2022 Budget	2023 Budget	2024 Budget
Transactions in Financial Assets and Liabilities	**2,048**	**3,505**	**4,631**	**3,769**	**2,425**	**2,242**	**2,395**
Transactions in Assets	**(1,229)**	**1,229**	**-**	**-**	**-**	**-**	**-**
Net Government Lending to other entities	(1,229)	-	-	-	-	-	-
Net Transactions from Government Accounts	-	1,229	-	-	-	-	-
Transactions in Liabilities (net basis)	**3,277**	**2,276**	**4,631**	**3,769**	**2,425**	**2,242**	**2,395**
Net Domestic Borrowing	**(319)**	**575**	**994**	**631**	**1,121**	**660**	**362**
Bonds	344	-	766	739	784	462	254
Treasury Bills	(517)	678	328	317	336	198	109
Loans	(146)	(103)	(101)	(425)	-	-	-
Net External Borrowing	**3,596**	**1,701**	**3,637**	**3,139**	**1,305**	**1,582**	**2,033**
Bonds	1,672	-	-	-	-	-	-
Loans	1,924	1,701	3,637	3,139	1,305	1,582	2,033
External Project loans	528	465	992	1,209	1,401	1,675	2,098
Commercial	602	(36)	(132)	(138)	(56)	(58)	(21)
Extraordinary	795	1,273	2,777	2,069	(41)	(36)	(45)
Other Economic Flows	**2,820**	**(18)**	**-**	**-**	**-**	**-**	**-**
Holding Gains and Losses	**1,498**	**(18)**	**-**	**-**	**-**	**-**	**-**
Domestic Borrowing - Holding Gains and Losses	**-**		**-**	**-**	**-**	**-**	**-**
External Borrowing - Holding Gains and Losses	**1,498**	**(18)**	-	-	-	-	-
Bonds	12	17	-	-	-	-	-
Loans	1,487	(35)	-	-	-	-	-
External Project loans	1,409	(35)	-	-	-	-	-
Commercial	170	-	-	-	-	-	-
Extraordinary	(93)	-	-	-	-	-	-
Other Changes in the volume of assets	**1,322**	**-**	**-**	**-**	**-**	**-**	**-**
Domestic Borrowing - Other changes in volume of assets	**1,322**	**-**	**-**	**-**	**-**	**-**	**-**
Bonds	-	-	-	-	-	-	-
Treasury Bills	-	-	-	-	-	-	-
Loans	1,322	-	-	-	-	-	-
External Borrowing - Other changes in volume of assets	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Bonds	-	-	-	-	-	-	-
Loans	**312**	**-**	**-**	**-**	**-**	**-**	**-**
External Project loans	184	-	-	-	-	-	-
Commercial	128	-	-	-	-	-	-
Extraordinary	228	-	-	-	-	-	-

	2018 Actual	2019 Supplementary	2020 Budget	2021 Budget	2022 Budget	2023 Budget	2024 Budget
Summary							
Total Central Government Debt	**28,480**	**32,536**	**37,167**	**40,936**	**43,361**	**45,603**	**47,998**
% GDP	36%	38%	40%	41%	39%	38%	38%
Total Central Government Debt Including Arrears	**31,103**	**34,518**	**38,097**	**40,936**	**43,361**	**45,603**	**47,998**
% GDP	39%	41%	41%	41%	39%	38%	38%

	2018 Actual	2019 Supplementary	2020 Budget	2021 Budget	2022 Budget	2023 Budget	2024 Budget
Stock of Liabilities							
Total Central Government Debt[1]	**28,480**	**32,536**	**37,167**	**40,936**	**43,361**	**45,603**	**47,998**
Domestic Debt	**17,000**	**18,470**	**19,464**	**20,095**	**21,215**	**21,875**	**22,238**
Bonds	8,322	8,022	8,788	9,527	10,312	10,774	11,027
Treasury Bills	8,678	9,272	9,600	9,917	10,253	10,451	10,560
Loans	1,279	1,176	1,076	651	651	651	651
External Debt	**11,480**	**14,066**	**17,703**	**20,841**	**22,146**	**23,728**	**25,761**
Bonds	1,684	1,701	1,701	1,701	1,701	1,701	1,701
Loans	9,797	12,365	16,002	19,141	20,445	22,027	24,060
External Project loans	7,106	8,262	9,254	10,463	11,864	13,539	15,638
Commercial	1,806	1,930	1,798	1,660	1,604	1,546	1,526
Extraordinary	884	2,172	4,949	7,018	6,977	6,942	6,897

1/ At end of period

Stock of Arrears							
Total Opening Stock of Arrears	**3,074**	**2,623**	**1,982**	**930**	**-**	**-**	**-**
Consisting of…	**3,074**	**2,623**	**1,982**	**930**	**-**	**-**	**-**
Personnel Emoluments	1,488	1,102	982	430	-	-	-
Goods and Services	665	600	400	200	-	-	-
Capital	921	921	600	300	-	-	-
Accumulated during the year	-	-	-	-	-	-	-
Personnel Emoluments	-	-	-	-	-	-	-
Goods and Services	-	-	-	-	-	-	-
Capital	-	-	-	-	-	-	-
Paid during the year	**451**	**641**	**1,052**	**930**	**-**	**-**	**-**
Personnel Emoluments	386	120	552	430	-	-	-
Goods and Services	65	200	200	200	-	-	-
Capital	-	321	300	300	-	-	-
Closing Stock and End of Year	**2,623**	**1,982**	**930**	**-**	**-**	**-**	**-**

Explanations of other flows

- **2018**: K1,322m, is the Government inclusion of 3 BSP guaranteed loans for Motu-Kea, Solwara and NCD Roads (the first principle payment was made in 2018)
- **2018**: There is a K228m movement between external project loans and commercial represents the reclassification of a loan
- **2018**: Inclusion of the previously disbursed loans from Ceska and Exim Bank China (correction on prior years): K411m under project loans, and K128m under commercial loans, recorded under Other Flows for the moment.

Explanation of Holding Gains and Losses

- **2018**: figures represent a correction of debt to market rates which were previously recorded at issuance value