2003 PAPUA NEW GUINEA NATIONAL BUDGET

PRICEWATERHOUSECOOPERS

28 November 2002

PwC BUDGET COMMENTARY

The Minister for Finance and Treasury, the Honourable Bart Philemon, MP, today handed down the 2003 National Budget.

Executive Summary

The theme of this year's budget is "Adjusting for Recovery and Development". In line with this, there has been an increase to the corporate tax rate and the introduction of a new debits tax on withdrawals from financial institutions. However, the Budget has also introduced some substantial tax incentives for the mining, petroleum and gas sectors.

2002 Budget – the year in review

The anticipated deficit in 2002 is K411.6 million (3.8% of GDP) up from the Budget estimate of K215 million (2.0% of GDP). This is marginally higher than the estimated deficit forecast at the time of the 2002 Supplementary Budget.

Key Budget Assumptions

The major assumptions on which the budget has been based are summarised in the table below –

STATE OF THE ECONOMY

	1999 act.	2000 act.	2001 act.	2002 est.	2003 proj.	Average (1999-2002)
Real GDP Growth (%)	7.6	-1.2	-3.4	-0.5	1.8	0.6
Agriculture (%)	4.3	9.1	-5.4	3.6	2.9	2.9
Mining (%)	15.0	4.3	2.4	-9.6	2.1	3.0
Petroleum (%)	0.0	-22.9	-9.6	-17.0	4.8	-12.4
Other Sectors (%)	8.4	-6.0	-3.3	1.6	0.8	0.2
Non-mineral GDP Growth (%)	6.9	-0.5	-4.2	2.4	1.6	1.2
Inflation (year average) (%)	14.9	15.6	9.3	12.0	13.2	13.0
Oil Price (US$ per barrel)	17.8	29.4	26.2	23.5	22.5	24.2
Gold Price (US$ per ounce)	301.0	301.0	282.0	300.0	309.0	296.0
Interest rates (182 day T-Bill) (average for year) (%)	23.3	18.0	12.6	11.0	13.5	16.2

Courtesy: Department of Finance and Treasury

Significant challenges

The Government has identified some significant challenges in the short and medium term and has expressed a commitment to taking the necessary action to meet these challenges.

The significant short term challenges that have been identified are as follows –

- Major downward pressure on the Kina;
- Emerging price inflation pressures with subsequent rise in interest rates on Government stock;
- Pressure on the balance of payments. While foreign reserves remain relatively comfortable, large external debt payments are due in 2003;
- Limited cash throughout the remainder of 2002 due to excessive spending in the first eight months of the year; and
- The real economy has been in recession for some years now with negative total GDP growth in 2000, 2001 and 2002.

The significant challenges over the medium term are –

- The decline in the mining and petroleum sectors with Real Mining and Petroleum GDP projected to contract sharply in 2005, 2006 and 2007; and
- The non-mining sectors that have performed poorly in recent years.

The 2003 Budget strategy aims to address the short term challenges and provide a basis for improving the medium term growth performance.

Government objectives

The Government aims to achieve the following objectives by the first two quarters of 2003 –

- stabilisation of the Kina;
- a decline in inflationary pressures;
- a phased reduction in interest rate levels;
- stabilisation of foreign reserve levels; and
- management of the 2003 Budget along normal, non-crisis lines.

Financing the Budget

2003 FINANCING

Kina Millions	2002 (est.)	2003
Tax revenue and grants	3,235	3,490
Total expenditure	3,500	3,732
Deficit(-) / Surplus(+)	-215	-244
% of GDP	-2.0%	-2.0%
External Financing	-39	-301
Concessional	-123	-80
Commercial	-33	-15
Extraordinary	117	-206
Domestic Financing	220	380
Domestic borrowing	-83	180
Temporary advance	-0	0
Asset sales	303	200
TOTAL	180	79

Courtesy: Department of Finance and Treasury

Total government expenditure of K3.732 billion against revenue and grants of K3.490 billion and a resultant budget deficit of K244 million, representing 2% of GDP is, in conventional economic terms mildly expansionary. These macro settings are going to be exceedingly difficult to achieve in the present economic climate. However, the Government is committed to achieving these targets and their forward planning is to be commended.

The budget anticipates K200 million in proceeds from asset sales in 2003. While the Government has not identified what assets are to be divested, the Budget papers do indicate that the Government anticipates that the privatisation of Telecom and The Harbours Board will be completed during 2003. At the same time, the non-tax revenue receipts are expected to fall by some 18.7% to K196.5 million, compared with the K241.8 expected in 2002. The explanation for the decline in the non-tax revenue receipts is given as there being no above-the-line receipts from asset sales in 2003 as there was in 2002. This inconsistency has not been adequately explained at this stage.

Finally, after an expected net decrease in domestic borrowing during 2002, an increase of K180 million in domestic debt is of some concern.

Key Initiatives

KEY INITIATIVES

- STRENGTHEN THE GOVERNMENT'S FISCAL CONSOLIDATION PROGRAMME TO PROMOTE MACROECONOMIC STABILITY AND TO IMPROVE PRIVATE SECTOR CONFIDENCE
- TO REDIRECT FINANCIAL RESOURCES INTO ACTIVITIES THAT ADDRESS THE GOVERNMENT'S ECONOMIC AND SOCIAL DEVELOPMENT PRIORITIES
- INCREASING THE CORPORATE TAX RATE TO 30%
- INCREASING THE TAX INCENTIVES AVAILABLE FOR THE MINING, PETROLEUM AND GAS SECTORS
- RETAINING MINING LEVY

Courtesy: Department of Finance and Treasury

The expenditure proposals were assessed against the objectives of the Government's programme for "Recovery and Development". The following five priority areas were identified as being necessary for the establishment of a foundation for the programme –

- Creating and improving access to markets through the rehabilitation and maintenance of transport infrastructure;
- Creating income-earning opportunities in agriculture, forestry and fisheries, including through the promotion of export opportunities;
- Securing peace and good order, through effective law and justice enforcement to further enhance social and economic opportunities;
- improving the delivery of, and access to, basic services in education and health, in order to empower Papua New Guineans to participate more productively in economic development; and
- improving the selection, effectiveness and accountability of Government programmes and services, through strengthening of governance processes.

Expenditure on repairs and maintenance on the Highlands Highway was allocated K85 million. A further K206 million has been allocated to other roads and bridges projects throughout the country.

The increase in the corporate tax rate to 30% was justified by the Government on the basis that the revenue collected in the transitional period from notional to provisional tax payments would lead to a significant decrease next year, when the transition was complete. Furthermore, the declining revenue from the mining and petroleum sectors will have to be supplemented. The increase appears contrary to the Government initiatives to encourage foreign investment and may not be well received by the corporate sector.

A new bank debits tax of 0.01% on all withdrawals from bank accounts is effective from 1 April 2003. This will replace the stamp duty on cheques that is currently imposed. However, it will not apply to passbook accounts.

The mining and petroleum sectors have received tax incentives to encourage further growth in these areas. The limitation to the carry forward losses for the industry have also been lifted. Accordingly, the losses may be carried forward indefinitely.

Revenue collection

The Budget contains a commitment to improve the collection of revenue by the Internal Revenue Commission (IRC). There is also a focus on improving efficiency within the Government departments so that revenue due to the Government is collected in a more timely manner. A representative of the IRC has indicated that the IRC is expected to employ a further 100 auditors to assist with the collection mechanism.

Other matters

- **Claims against the State**
  An amendment is proposed to the *Claims By and Against the State Act* to render certain contracts unenforceable in the absence of an ILPOC or other appropriate documentation.

- **Settlement of arrears**
  K60 million has been appropriated to pay arrears owing by the State compared with K16 million estimated in the 2002 Supplementary Budget.

- **Gifts to political parties**
  The provisions relating to the deduction for gifts to political parties has been amended to be in line with those contained in the *Organic Law on Political Parties.*

- **Free education**
  The free education policy initiated by the previous Government has been revoked on the basis that it is unsustainable.

❖ *INCOME TAX*

Corporate Tax Rates

- There has been an increase in the corporate tax rate from 25% to 30%. This will apply to income derived on or after 1 January 2003.

Personal Tax Rates

- There has been no change to the personal income tax rates. However, the taxable value of housing and motor vehicles have increased by 25%. The revised tables are reproduced as Appendix A.

Export Tax - Logs

- The export tax on logs will be based on the United States Dollar (USD) values to reflect the currency of the sale.

❖ *THE MINING, PETROLEUM AND GAS PROVISIONS*

In addition, a number of amendments to the operation of the Mining, Petroleum and Gas Provisions have been made the more significant of which are detailed below.

Mining

- The Additional Profits Tax has been abolished.

- The ring fencing, which limits the amount of new exploration expenditure that can be deducted from the income of current mining projects, is eased to increase the amount by which tax can be reduced from 10% to 25%.

- A double tax deduction is introduced for exploration by existing mining companies. Exploration expenses for new projects to be deducted initially as noted above. If the exploration is successful, the exploration expenses can also be subsequently deducted against the mining income that is generated.

- Capital expenditure on new developments may be deducted from income at the rate of 25% of the residual value at the end of each year. (It is currently deducted at the rate of 10%). This will defer the tax payable but will not affect the total tax payable over the life of the project (assuming no change in the tax rates).

- Mining companies that choose to use the provisions for fiscal stabilisation will incur an additional 2% premium on the company tax rate applicable to them, during the period of stabilisation.

- The mining levy applicable to current mining projects was to be phased out over four years. However, no further reductions will apply, leaving the mining levy at 75% of the full amount.

Petroleum

- The first tier of the Additional Profits Tax has been abolished. Therefore the Additional Profits Tax will only apply when a rate of return of 20% is reached.

- A new tax concession applies to any development commencing before 2017 that results from an exploration licence issued between 2003 and 2007. The tax rate applicable to the revenue earned will be 30% with no tax on dividends.

Gas

The following provisions will only apply if the Gas Project proceeds –

- Special tax credits will be available for payment of the State's share of construction costs of new roads and highways in the Southern Highlands and Gulf provinces. These tax credits may be utilised to offset any income tax payable.

- There will be a limit of K5,000 imposed on the stamp duty payable on certain company transfers to facilitate the Gas Project.

- Customs duty is removed from major imports used in the construction of the gas project and set at the rates that will start in 2006 for all other imports.

❖ *CUSTOMS, EXCISE AND INDIRECT TAXES*

Excise Duty – Alcohol and Tobacco

- The excise duty on alcohol and tobacco products will increase from 2.5% to 4% at six monthly intervals on 1 June and 1 December of each year.

Customs Duty - Salt

- Customs duty of 40% will be imposed on salt packed for retail sale only. There will be no duty imposed on the bulk importation of salt used in PNG canning and food industries. The government has indicated that the protection will lapse after one year unless the company concerned moves from repackaging imported salt to production of salt in local salt pans.

- Imports of bulk soap powder will become duty free. However, the protective duty on soap powder packaged ready for retail sale is reduced.

Debits Tax

- A bank debit tax of 0.01% on all withdrawals from bank accounts will be applicable from 1 April 2003. However, this will not apply to passbook account withdrawals.
- The stamp duty on cheques is to be abolished on the same date.

Appendix A

Prescribed Housing Benefits

	Current Rent per week	Sale	New Rent per week	Sale
Low cost housing	Less than K250	Less than K75,000	Less than K315	Less than K95,000
Medium cost housing	K250 - K750	K75,000 to K175,000	K315 - K950	K95,000 to K220,000
High cost housing	More than K750	More than K175,000	More than K950	More than K220,000

Current Prescribed Benefits

	Area 1	Area 2	Area 3
High cost house or flat	K180	K125	Nil
Medium cost house or flat	K105	K80	Nil
Low cost house or flat	K45	K40	Nil
Mess/Barracks	K45	K40	Nil
Government Mess/Barracks	K5	K5	Nil
Approved low cost housing	Nil	Nil	Nil

New Prescribed Benefits

	Area 1	Area 2	Area 3
High cost house or flat	K225	K156	Nil
Medium cost house or flat	K131	K100	Nil
Low cost house or flat	K55	K50	Nil
Mess/Barracks	K45	K40	Nil
Government Mess/Barracks	K5	K5	Nil
Approved low cost housing	Nil	Nil	Nil

Prescribed Motor Vehicle Benefits

Motor vehicles without fuel – K95 per fortnight

Motor vehicles with fuel – K125 per fortnight

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