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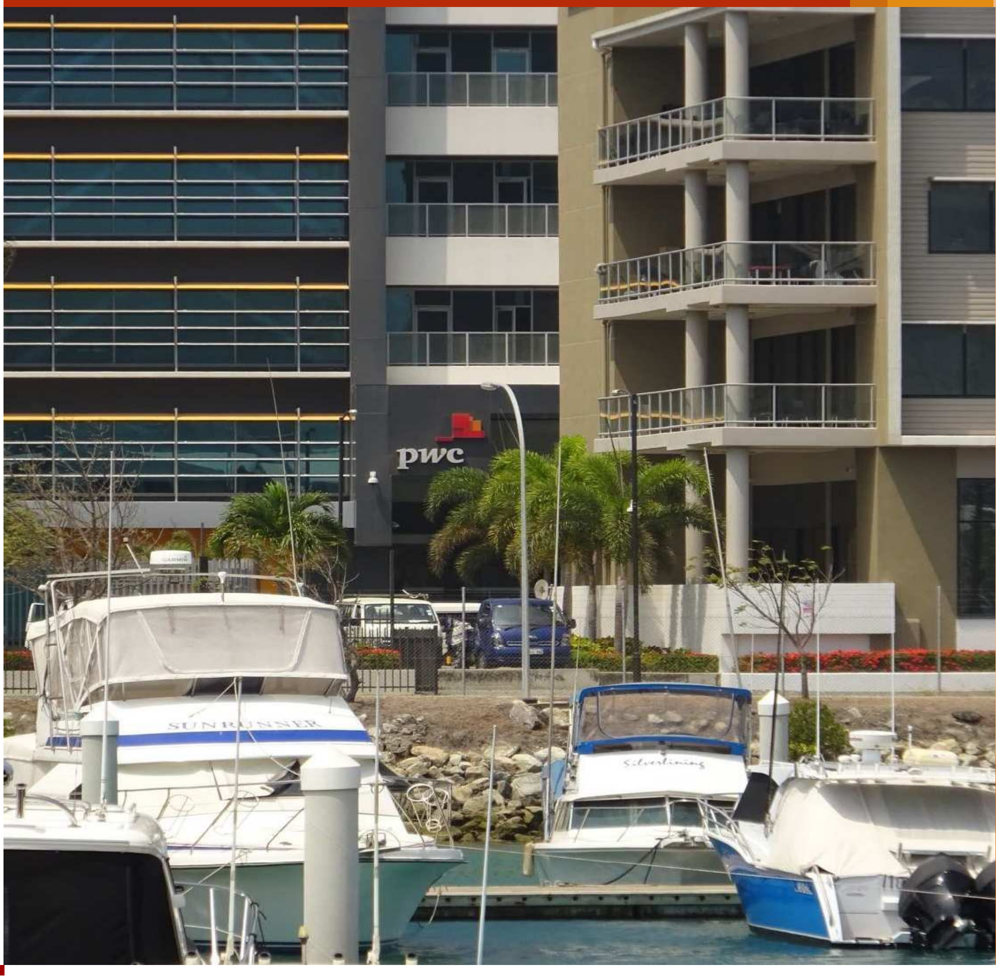
Papua New Guinea 2017 National Budget

"Responsible fiscal consolidation for future growth and development"



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The Minister for Treasury, the Honourable Patrick Pruaitch, MP handed down the 2017 National Budget on 1 November 2016.

Executive Summary

The theme of the 2017 National Budget is *"Responsible fiscal consolidation for future growth and development"* and is set at K13,349.5 million against projected revenue of K11,473.1 million.

The 2017 Budget is expected to result in a net borrowing position of 2.5% of GDP and a debt-to-GDP ratio of around 28.8 per cent in 2017 and 2018, declining thereafter to 27.0 per cent in 2021.

The Budget is set within the Government's overarching development frameworks, including the Vision 2050, the Development Strategic Plan (2010 – 2030), the Medium Term Development Plan 2 (MTDP2) (2016-2017), the Strategy for Responsible Sustainable Development (StaRS2017), and the Fiscal Responsibility Act 2006 (FRA). It has been framed amidst a relatively weak global economy still recovering from low commodity prices and lower than anticipated growth of the domestic economy.

Key components of the 2017 Budget include:

- The PNG economy is projected to grow at 2.8 per cent in 2017.
- Inflation is expected to increase to around 7 per cent due to the continued depreciation of the Kina exchange rate and volatile movements in the prices of seasonal items.
- PNG's current account balance is expected to maintain a surplus position of K11,449.8 million in 2016 due to the recovery of the agriculture sector from El Nino, the resumption of production from Ok Tedi mine and the continuing production from the PNG LNG project.
- In 2017, Total Revenue is projected at K11,473.1 million, K248.4 million below the 2016 Supplementary Budget estimate.
- Total expenditure in 2017 is estimated to be K13,349.5 million, a reduction of K485 million from the 2016 Supplementary Budget of K13,834 million.
- The 2017 Budget includes potentially significant amendments from a taxation viewpoint including, resourcing the IRC to improve compliance, changes to corporate income tax, foreign contractor withholding tax and dividend withholding tax rates, imposing APT across all mining and petroleum projects and adjusting the taxable value of employer provided housing.

2016 Budget Update

The 2016 performance against Budget has been significantly impacted by low commodity prices, the effects of the El Nino drought in 2015 and 2016 and the imbalance in the foreign currency market. The 2016 Supplementary Budget was introduced to adjust for the shortfall in revenue of K1,886.0 million. The 2016 Supplementary Budget reduced expenditure by K928.0 million and increased revenue by K958.0 million. These adjustments ensured that the planned deficit remained at K2.1 billion or 3.1 per cent of GDP and Debt to GDP ratio remained at 29.4 per cent.

2017 Budget – Key Budget Assumptions

The major assumptions on which the budget has been based are summarised in the following table. Historic indicators are also included for reference purposes.

Principal economic indicators	2015 est	2016 proj	2017 proj	2018 proj	2019 proj	2020 proj	2021 proj
Real GDP growth (%)	11.8	2.0	2.8	2.7	2.7	2.6	2.7
Non-mining GDP growth (%)	2.0	2.5	3.0	3.5	3.5	3.5	3.4
Inflation (year average) (%)	6.0	6.6	7.0	6.6	5.6	5.2	5.0
Exchange rate (real exchange rate index 2007=100)	141.0	129.4	133.2	137.8	141.8	145.6	149.1
Interest rate (Kina Rate Facility)	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Gold price (US$ per ounce)	1,160	1,267	1,301	1,315	1,331	1,354	1,370
Copper price (US$ per tonne)	5,502	4,724	4,832	5,084	5,123	5,294	5,498
Oil price (US$ per barrel)	49	42	50	54	55	57	59
Nickel (US$ per tonne)	11,831	9,351	10,459	11,374	12,148	12,683	14,250
Cobalt (US$ per tonne)	29,255	24,212	25,243	25,865	27,046	27,861	28,784

Source: Department of Treasury

The Economy

Global

The global economy has weakened in 2016. According to the 2016 October World Economic Outlook (WEO) report published by the International Monetary Fund (IMF), the global economy growth is projected to slow to 3.1 per cent in 2016. A more subdued outlook for advanced economies following the June UK vote in favour of leaving the European Union (Brexit) and weaker-than-expected growth in the United States (US) have contributed to the slowdown in global growth. These developments have put further downward pressure on global interest rates, as monetary policy is now expected to remain accommodative for a longer period.

Growth in the advanced economies is projected at 1.6 per cent for 2016; down 0.3 percentage points from the 2016 April WEO. Growth in the emerging and developing economies (ie BRIC countries, Middle East and North Africa) is expected to strengthen slightly in 2016 to 4.2 per cent.

In 2017, the global economy is projected to recover gradually, growing at 3.4 per cent driven by the emerging and developing economies. Growth in the advanced economies is expected to pick up slightly to 1.8 per cent due to the strengthening of the recovery in the US and Canada and a rebound in Japan due to recent fiscal stimulus.

Domestic

Real GDP is expected to grow at 2.0 per cent in 2016, a downward revision from the 2016 Mid - Year Economic and Fiscal Outlook (MYEFO) Report estimate of 2.2 per cent and the 2016 Budget estimate of 4.3 per cent. The downgrade in growth reflects the prevailing low commodity prices, lower than anticipated production from the mining and oil and gas sectors and weather issues affecting the agriculture sector. This is further exacerbated by the reduction in Government spending in the economy and the shortages of foreign exchange to purchase imports.

The oil and gas sector is estimated to contract by 1.3 per cent in 2016 following strong growth in 2014 and 2015. The contraction reflects declining oil production profile associated with maturing oil fields and gas production reaching full capacity.

The mining and quarrying sector is estimated to grow at 8.2 per cent in 2016, a downward revision from the 2016 MYEFO estimate of 9.4 per cent and the 2016 Budget estimate of 9.3 per cent due to improved production from Ok Tedi mine, Ramu nickel mine and Porgera mines.

The agriculture, forestry and fishery sector is expected to grow by 3.1 per cent in 2016, a downward revision from the 2016 MYEFO estimate of 3.4 per cent and the 2016 Budget estimate of 3.8 per cent due to the impact of the 2015 drought on key palm oil projects in Ramu and West New Britain Province while coffee has benefited from the drought.

Activities in the other non-resource sectors of the economy continue to be affected by the indirect impacts of the depressed commodity prices through reduction in income and spending in the economy and the shortages in foreign currencies. The total non-mining GDP growth has been revised down to 2.5 per cent in 2016 from 2.6 per cent growth estimated at 2016 MYEFO and the 2016 Budget estimate of 3.4 per cent.

The manufacturing sector is expected to grow at 2.0 per cent in 2016, a downward revision from 4.0 per cent at Budget. The downgrade is stated to be due to stiff competition from cheaper imports and the lack of foreign currencies at the banks to facilitate import demand.

Growth in the wholesale retail and trade sector for 2016 has been revised down to 1.9 per cent from 3.0 per cent estimated at 2016 MYEFO due to weak sales and the impact of the shortage in foreign currencies to source imports.

The construction sector is expected to grow at 1.6 per cent in 2016, a downward revision from 3.0 per cent estimate at 2016 Budget due to the reduction in Government capital expenditure in 2016 and the general slowdown of business activities. Despite these developments, the construction sector continues to benefit from a number of major construction projects funded under concessional loans from donor partners.

The electricity, gas and water sector is expected to grow at 3.0 per cent in 2016, a downward revision from the estimated 5.0 per cent at Budget. The growth of this sector continues to reflect Government's ongoing capital investment in PNG Power Limited, developments in other sectors of the economy, mainly the real estate sector, town expansion, urbanisation and population growth.

The transport, storage and communication sector is expected to grow at 4.0 per cent in 2016 driven by the expansion in the communication and transport sector. A major contributor to growth in 2016 is the extension of flights internationally and domestically including the rural areas of PNG. The expansion in the communication sector reflects diversification into television services and mobile banking services.

The finance, real estate and business services sector is expected to grow by 3.0 per cent in 2016 driven by the finance sector.

Activity in the community, social and personal services sector continue to reflect developments in the government's expenditure programs. This sector is expected to grow at 3.0 per cent in 2017.

Exchange Rate Developments

PNG's Trade Weighted Index (TWI) has continued to decline since the start of 2016. Over the past ten months of 2016, the PNG TWI declined by 10.8 per cent compared to the corresponding period in 2015. The decline in TWI reflects ongoing depreciation of the PNG Kina against the key trading currencies, particularly, the US dollar and the Australian Dollar. The Kina depreciated by 11.4 per cent and 10.0 per cent against the US Dollar and Australian Dollar respectively.

The Kina also depreciated against all other key trading currencies: including Singapore Dollar (11.5 per cent), Chinese Renminbi (7.2 per cent), Hong Kong Dollar (11.3 per cent), Philippines Peso (8.5 per cent), Japanese Yen (20.4 per cent), New Zealand Dollar (10.3 per cent), Malaysian Ringgit (6.9 per cent) and Euro (11.8 per cent) amongst others.

The depreciation of the Kina against the US Dollar continues to reflect the persistent imbalance in the PNG foreign exchange market. Domestic import demand remained relatively high against supply due to the low foreign currency inflows and a backlog of import orders. The depreciation of the Kina against the Australian

Dollar is attributed to the strengthening of the Australian Dollar against the US Dollar on the back of favourable Australian economic developments and increase in commodity prices.

The 2017 Budget

The 2017 Budget will be guided by the Vision 2050, PNG Development Strategic Plan (DSP) (2010-2030), the Medium Term Development Plan 2 (MTDP2) (2016-2017), the Strategy for Responsible Sustainable Development (StaRS2017), and the Fiscal Responsibility Act 2006 (FRA).

The 2017 Budget is set against the backdrop of a relatively weak world economic environment and lower than anticipated growth of the domestic economy. Despite this the 2017 Budget accommodates the government priority expenditures and aims to maintain disciplined fiscal management by adhering to FRA.

In 2017, total expenditure is projected to be K13,349.5 million, which is K485.0 million lower than the 2016 Supplementary Budget.

Total revenue in 2017 is projected to be K11,473.1 million, being K248.4 million lower than the 2016 Supplementary Budget projection. The 2017 Budget will continue to fund key priority expenditures such as the Tuition Fee Free Education, Free Primary Health Care, Infrastructure Projects, Agriculture and Small to Medium Enterprises. Apart from funding these priorities, funding for National General Elections and 2018 APEC will be the highest priority for the 2017 Budget.

In the 2017 Budget, the deficit and net borrowing are at K1,876.5 million or 2.5 per cent of GDP.

The budget (Kina millions)	2015 Actual	2016 Budget	2016 Supp. Budget	2017 Budget
Revenue	10,776.4	12,650.1	11,722.1	11,473.1
Expenditure	13,788.8	14,762.6	13,834.6	13,349.5
Net Borrowing (-)	-3,012.4	-2,112.5	-2,112.5	-1,876.5
% of GDP	-4.9%	-3.1%	-3.1%	-2.5%
Debt to GDP (%)	**29.1%**	**29.3%**	**29.4%**	**28.8%**

Source: Department of Treasury

Financing the Budget

The Central Government stock of debt continued to increase in 2016 as the Government continued to borrow in the domestic and international markets to fund the deficit. Interest rates were steadily increasing over 2016, the outcome of low demand for Treasury Bond (Inscribed Stock) over the first half of the year. Demand remained moderately low for Treasury Bills throughout the year.

A first tranche of US$ 200.0 million of the Credit Suisse syndicated loan was disbursed in August 2016. The second tranche is expected in November.

The debt-to-GDP ratio is expected to be around 28.8 per cent in 2017 and 2018, declining thereafter to 27.0 per cent in 2021.

International Development Partners have provided assistance through concessional foreign currency project loans.

Set out below are the Budget forecasts to 2021, showing a deficit of 2.5 per cent in 2017.

Budget Balance 2015 – 2021 (Kina millions)	2015	2016	2017	2018	2019	2020	2021
Net Borrowing (-) / Net Lending (+)	-3,012.4	-2,112.5	-1,876.5	-1,839.6	-1,570.4	-1,215.1	-699.8
2017 Budget: Budget Balance (% of GDP)	-4.9	-3.1	-2.5	-2.3	-1.8	-1.3	-0.7
Debt as % of GDP	29.1	29.4	28.8	28.8	28.7	28.1	27.0
MTFS 2013–2017 Budget Balance (% of GDP)	-1.6	-0.6	0.1	0.0	0.0	0.0	0.0
MTFS 2013–2017 Implied debt to GDP (%)	28.9	27.5	25.4	0.0	0.0	0.0	0.0

Source: Department of Treasury

Foreign currency denominated loans and bond issuance

The Government's predominant form of foreign currency borrowing has been concessional loans from bilateral and multilateral development partners. These are generally repayable over 20-30 years with very concessional interest rates and long grace periods.

The Government intends to undertake net external financing of K183.0 million through concessional loans of K128.6 million and commercial loans of K54.4 million. This comprises of expected gross external borrowings of K452.8 million and external repayments of K269.8 million.

The Government will continue to seek other external financing apart from concessional loans in 2017 as part of the financing strategy. The external financing is expected to ease the pressure on domestic markets and reduce the risk of refinancing short term domestic securities.

Public Debt

Total public debt is estimated to increase from K19,784.7 million in 2016 to K21,623.3 million at the end of 2017. Debt to nominal GDP is projected to decline from 29.4 per cent in 2016 to 28.8 per cent in 2017 well within the Fiscal Responsibility Act 2006 limit of 30 per cent.

The sources of the Central Government's financing are set out below.

Central Government Financing (Kina millions)	2016 Balance (estimated)	2017 Repayment (estimated)	2017 Borrowing (estimated)	2017 Balance (estimated)	2017 Net Change
Domestic Debt	**13,369.4**	**8,167.9**	**8,323.5**	**13,525.0**	**155.6**
Treasury Bills	5,720.7	7,485.5	7,423.5	5,658.7	62.1
Inscribed Stock	7,648.6	682.3	900.0	7,866.3	217.7
External Debt	**6,415.3**	**269.8**	**1,952.8**	**8,098.3**	**1,683.0**
International Agencies	4,759.5	269.8	452.8	6,598.3	183.0
Foreign Bonds	1,655.8	0.0	1,500.0	1,500.0	1,500.0
Total	**19,784.7**	**8,437.7**	**10,276.3**	**21,623.3**	**1,876.5**
% of Nominal GSP	29.4%			28.8%	

Source: Department of Treasury

Revenue and Grants

In 2017, Total Revenue is projected at K11,473.1 million, comprising of K9,182.2 million in Tax Revenue, K1,045.3 million in Grants (donor grants component of K968.1m) and K1,245.7 million from Other Revenues (dividends and department fees and charges). Compared to the 2016 Supplementary Budget estimate, Total Revenue is lower by K248.4 million.

In 2016, Total Revenue is projected to be lower by K639.2 million compared to 2016 revised projections, due to weaker collections from key revenue sources mainly Wages and Salary Taxes, Mining Petroleum Tax and dividends. A breakdown of the total budgeted revenue and grants for 2017 is set out below.

Total Revenue and Grants (Kina million)	2015 Actual	2016 Budget	2016 Supp. Budget	2016 Revised	2017 Budget	Variation
Tax Revenue	**9,157.6**	**10,525.6**	**8,825.8**	**8,453.2**	**9,182.2**	**356.4**
% of GDP	*15%*	*16%*	*13%*	*12.6%*	*12.2%*	
Grants	**819.5**	**1,513.2**	**1,948.0**	**1,881.4**	**1,045.3**	**-902.7**
% of GDP	*1.3%*	*2.2%*	*2.9%*	*2.8%*	*1.4%*	-
Other Revenue	**1,026.0**	**611.3**	**947.7**	**747.7**	**1,245.7**	**298.0**
% of GDP	*1.7%*	*0.9%*	*1.4%*	1.1%	1.7%	
Total Revenue	**11,003.1**	**12,650.1**	**11,721.5**	**11,082.3**	**11,473.1**	**-248.4**
% of GDP	*17.8%*	*18.8%*	*17.4%*	*16.5%*	*15.3%*	*-0.02*

Source: Department of Treasury

Tax Revenue

Taxes on Income, Profits and Capital Gains

Taxes on Income Profits and Capital Gains are estimated at K5,818.9 million comprising of K3,035.7 million in Personal Income Tax, K2,433.9 million in Company Income Tax, K154.2 million in Mining and Petroleum Tax (MPT), K138.8 million in Dividend Withholding Tax, K77.8 million in Interest Withholding Tax and K54.9 million in Royalties and Management Tax.

A decline in some key economic sectors led to a reduction in anticipated collections from Personal Income Tax by K228.3 million from the 2016 Supplementary Budget estimate of K3,077.4 million. Compared to the 2016 revised projections of K2,849.1 million, Personal Income Tax for 2017 is expected to be higher by K186.6 million due to a tax measure on employer provided housing benefit, a projected increase in employment, improved business activity from a gradual improvement in commodity prices, a better growth outlook for the agriculture and mining sectors and due to APEC constructions.

Taxation revenue 2015-2017 (Kina millions)	2015 (Actual)	2016 (Budget)	2016 Supp. Budget	2016 Revised	2017 Budget	Variation
Taxes on Income, Profits and Capital Gains	**5,894.2**	**6,764.4**	**5,657.8**	**5,375.1**	**5,818.9**	**161.0**
Personal income tax	3,037.1	3,511.7	3,077.4	2,849.1	3,035.7	-41.7
Company tax	2,374.8	2,793.2	2,230.3	2,230.1	2,433.9	203.6
Mining and petroleum tax	195.4	129.9	88.8	21.9	77.1	-11.7

Taxation revenue 2015-2017 (Kina millions)	2015 (Actual)	2016 (Budget)	2016 Supp. Budget	2016 Revised	2017 Budget	Variation
Royalties Tax Management Tax	51.3	43.4	40.5	53.5	54.9	14.4
Dividend Withholding Tax	168.9	232.7	151.0	133.7	138.8	-12.1
Interest Withholding Tax	66.0	52.7	69.2	86.4	77.8	8.7
Tax Related Court Fines	0.0	0.0	0.0	0.0	0.0	0.0
Sundry IRC Taxes & Income	0.6	0.8	0.7	0.4	0.5	-0.2

Source: Department of Treasury

Taxes on Payroll and Workforce

Taxes on Payroll and Workforce are projected to be K17.6 million in 2017, mainly from the Training Levy, an increase of K0.6 million from the 2016 Supplementary Budget.

Taxes on Payroll & Workforce (Kina millions)	2015 (Actual)	2016 (Budget)	2016 Supp. Budget	2017 Budget	Variation
Training Levy	18.0	17.0	17.0	17.6	0.6
Total	**18.0**	**17.0**	**17.0**	**17.6**	**0.6**

Source: Department of Treasury

Taxes on Goods and Services

Taxes on Goods and Services are projected at K2,762.2 million in 2017 (being K1,484.7 million in gross GST collections, K691.1 million in Excise Duty, K300.3 million in Import Excise and K180.5 million in Gaming Machine Turnover Tax).

The gradual increases in commodity prices in the agriculture and the mining sectors in 2017 are expected to support income and spending on goods and services in the economy. This is expected to be strengthened by the election related spending, sales and GST collections at the provinces and the ports.

The gradual improvements in income and spending in the economy are expected to support the sales of excise related items thus increasing Excise Duty and Import Excise. The Excise Duty will be supported by a one-off increase in the base rate on Tobacco, an increase in excise indexation rate of alcohol and a levy on diesel. Compared to the 2016 Supplementary Budget estimate, the Excise Duty and the Import Excise are expected to be higher by K121.3 million and K27.4 million, respectively.

Gaming Machine Tax and Bookmakers Turnover Tax are expected to increase by K12.3 million and K32.1 million respectively and will be supported by tax measures.

Taxes on Goods & Services	2015 (Actual)	2016 (Budget)	2016 Supp. Budget	2016 Revised	2017 Budget	Variation
Taxes on Goods & Services	**2,680.2**	**3,137.4**	**2,583.8**	**2,513.6**	**2,762.2**	**178.4**
GST	1,567.0	1,759.0	1,430.3	1,459.0	1,484.7	54.4
Stamp Duties	126.1	117.8	115.8	55.8	42.9	-72.9
Excise Duty	503.3	734.8	569.8	571.2	691.1	121.3
Import Excise	298.7	316.7	272.9	273.7	300.3	27.4

Taxes on Goods & Services	2015 (Actual)	2016 (Budget)	2016 Supp. Budget	2016 Revised	2017 Budget	Variation
Bookmakers' Turnover Tax	9.4	14.9	10.3	8.9	42.4	32.1
Gaming Machine Turnover Tax	162.1	176.5	168.2	131.5	180.5	12.3
Departure Tax	6.2	6.8	6.8	3.9	11.3	4.5
Motor Vehicle Registration	5.7	7.2	7.2	7.2	7.2	0.0
Other taxes on use of goods and on permission to use goods or perform activities	1.1	0.9	0.9	0.9	0.8	0.0
Other taxes on goods and services	0.4	2.9	1.6	1.6	0.9	-0.7

Source: Department of Treasury

Grants

Grants for 2017 are projected at K1,045.3 million. Of this, donor grants are projected to be K968.1 million and K77.2 million is expected from the drawdown of Sovereign Wealth Fund (SWF) funds. Donor grants are subject to movements in the exchange rate and policies of donors.

Grants	2015 (Actual)	2016 (Budget)	2016 Supp. Budget	2016 Revised	2017 Budget	Variation
GRANTS	**819.5**	**1,513.2**	**1,948.0**	**1,881.4**	**1,045.9**	**-902.7**
From Foreign Governments	778.8	998.8	998.8	998.8	968.1	-30.7
From International Organisations	40.7	135.3	135.3	135.3	0.0	-135.3
From Other General Government Units	0.0	379.1	813.9	747.3	77.2	-736.7

Source: Department of Treasury

Grants in 2016 are expected to decrease by K166.0 million. This is due to a downward revision in transfers from expected operation of the SWF. The downward revision is the result of weaker than anticipated revenue flows from mining and petroleum tax to the SWF. Donor Grants remained unchanged at K1,134.1 million.

Other Revenue

In 2017, Other Revenue is projected at K1,245.7 million comprising mainly of K1,075.0 million in dividends, K51.1 million in Rent (mainly land lease rentals) , K91.2 million from Sales of Goods and Services, K0.8 million in Fines Penalties and Profits and K23.6 million in Transfers not elsewhere classified.

Of the total dividends, K100.0 million is expected from Kumul Consolidated Holdings, K300.0 million from Kumul Petroleum Holdings, K150.0 million from National Fisheries Authorities, K200 million from Ok Tedi mine, K75.0 million from National Gaming Board, K25.0 million from Motor Vehicle Insurance, K150.0 million from the Bank of Papua New Guinea and K75.0 million from Other State entities. Compared to the 2016 Supplementary Budget estimates, dividends for 2017 are expected to be higher by K352.2 million.

Other Revenue	2015 (Actual)	2016 (Budget)	2016 Supp. Budget	2016 Revised	2017 Budget	Variation
OTHER REVENUE	**1,026.0**	**611.3**	**893.4**	**747.7**	**1,245.7**	**352.2**
Property Income	**943.1**	**516.9**	**853.3**	**653.3**	**1,130.1**	**276.8**
Interest	0.0	4.0	4.0	4.0	4.0	0.0
Dividends	911.4	480.0	816.4	616.4	1,075.0	258.6
Mining, Petroleum and Gas Dividends	456.4	300.0	500.0	300.0	500.0	0.0
Dividends from Statutory Authorities	85.0	45.0	178.0	178.0	375.0	197.0
Dividends from State Owned Enterprises	370.0	135.0	138.4	138.4	125.0	-13.4
Other Dividends	0.0	0.0	0.0	0.0	75.0	75.0
Rent	31.7	32.9	32.9	32.9	51.1	18.2
Sales goods and services	**65.6**	**85.4**	**31.1**	**85.4**	**91.2**	**60.1**
Administrative fees	25.3	31.1	31.1	31.1	38.8	7.7
Incidental sales by nonmarket establishments	40.3	54.3	0.0	54.3	52.4	52.4
Fines, penalties, forfeits	**2.8**	**0.8**	**0.8**	**0.8**	**0.8**	**-0.1**
Other transfers	**14.4**	**8.2**	**8.2**	**8.2**	**23.6**	**15.4**

Source: Department of Treasury

Expenditure

Total expenditure in 2017 is estimated to be K13,349.5 million, of which, K11,928.7 million is GoPNG funded and K1,420.9 million is donor funded. The donor funding comprises of K452.8 million in loans and K968.1 million in grants. The total expenditure is lower by K485.0 million or 3.6 per cent from the 2016 Supplementary Budget.

The following are the main Budget priorities:

- enhancing opportunities by building the foundation for the future development of the country while recognising the need for macroeconomic stability by returning to a balanced budget beyond 2021;
- continuing to support policy priorities in education, health, infrastructure, agriculture and tourism sectors, Rural development and Small to Medium Enterprises;
- facilitating the 2017 General Elections and hosting of the 2018 APEC Summit;
- promoting efficient and effective implementation of major projects through improving design, scoping, and implementation processes;
- placing more emphasis on monitoring, evaluation and compliance so as to achieve improved development outcomes;
- strengthening efficiency in the public sector; and

- strengthening and improving spending controls particularly in relation to the escalating public sector wage bill.

Expenditure by Sectors	2016	2017	2018	2019	2020	2021
Administration	2,219.2	2,732.3	2,702.1	2,549.3	2,476.0	2,443.8
Community & Culture	149.7	224.6	222.2	209.6	203.6	200.9
Economic	452.4	398	393.6	371.3	360.7	356
Education	1,242.8	1,162.5	1,149.7	1,084.7	1,053.5	1,039.8
Health	1,536.7	1,221.5	1,208.0	1,139.7	1,106.9	1,092.5
Law & Justice	1,232.6	1,124.5	1,112.10	1,049.2	1,019.0	1,005.8
Provinces	3,565.8	3,989.9	4,020.20	4,040.7	4,059.5	4,090.1
Transport	1,025.2	897.1	887.2	837.1	813	802.4
Utilities	371.5	216.2	213.8	201.7	195.9	193.3
Debt Services	1,479.6	1,382.9	1,367.6	1,290.3	1,253.2	1,236.9
Total	**13,280.9**	**13,349.5**	**13,276.5**	**12,773.6**	**12,541.3**	**12,461.5**

Source: Department of Treasury

National Reform Agenda

In 2017, the Government will undertake a number of important public sector adjustments that are necessary to improve the quality of public sector spending. These initiatives aim to deliver essential services more efficiently and effectively.

In 2016, the Public Sector Reform Working Group (PSRWG) identified a number of government agencies for amalgamation and abolishment.

The Government will further look at ways to reduce wastage in the public sector pay bill and improve the public sector efficiency through the commencement of the Organizational, Staffing and Personnel Emolument Audit Committee (OSPEAC).

The Government will also work with key stakeholders in removing the impediments to doing business and investment in PNG. The results from the Competition Review and the Financial Sector Services Review in 2016 will be released in 2017.

These reforms are designed to achieve the development outcomes as planned in the existing development policies and strategies, such as the Vision 2050 and the PNG Development Strategic Plan 2010 – 2030 (DSP).

Taxation Developments and Amendments

The Government received the report from the Taxation Review Committee (TRC) in 2015 following two years of work by the Committee and has considered the recommendations in the report. The review was part of the Government's ongoing effort to initiate and develop ways to improve its taxation policy and administration and contribute to a modern and efficient tax system that is able to support PNG's economic and social development objectives.

In the 2017 Budget the Government introduces a number of revenue and administrative measures, which are broadly consistent with the TRC's recommendations. The 2017 Budget introduces another 9 of the recommendations from the TRC. As a result, a total of 15 of the TRC's recommendations have now been introduced and the Government has undertaken to review more recommendations next year.

The measures are aimed at improving compliance, increasing revenue, encouraging spending in productive areas and making the taxation treatment simple and efficient. These measures are critical to support the Government's effort to make tax administration responsive and efficient.

In the 2017 budget, the Government introduces significant changes including:

- additional resources for revenue raising agencies, especially the IRC and Customs to improve compliance;
- standardises the taxation treatment of corporate income tax, dividends, interest and foreign contractors across all sectors of the economy;
- imposes Additional Profits Tax across all mining and petroleum project developments;
- repeals double deduction provisions for exploration expenditure;
- adjusts the taxable component of employer (provided) housing benefits;
- implements the minimum reporting standards applicable to Base Erosion & Profit Shifting (BEPS);
- increases the taxation on unprocessed old-growth logs;
- increases excise on alcohol and tobacco to meet the cost of law and order, social and health expenses;
- redistributes the gross profits of gaming machines to increase the Government share;
- increases excise on diesel fuel for maintenance of existing national road networks;
- merges bookmaker's stamp duty with bookmaker's turnover tax (BTT) and increases the rate of BTT;
- increases departure tax from K30 to K114;
- introduces minor policy and housekeeping technical amendments to simplify administration, correct typographical errors and outdated referencing to clarify the law for ease of administration.

The main tax measures are summarised below.

Additional resources for revenue raising agencies

The TRC in its findings recommended reforms in revenue administration to ensure a highly efficient and effective revenue collection. The Government recognises that under investment in revenue administration attributes to significant compliance issues, tax avoidance, tax planning and subsequent revenue losses.

The Government acknowledges that collecting tax revenue is very labour intensive and requires increased resources to cover other centres of PNG to increase the tax base. As a result, the Government is providing increased funding of K90 million to the IRC in 2017, an increase of K16 million above the 2016 appropriation. The increased funding aims to resource IRC for improved compliance and broaden the tax base.

Of the K90 million, K5 million will be for a joint Task Force on compliance enforcement. The members of the joint Task Force will comprise of senior Treasury and IRC officials with the Department of Treasury providing the secretariat. The terms of reference will be finalised and presented to NEC for approval in early 2017, which will include outsourcing/engaging reputable international accounting firms to audit major companies.

With the increased funding for 2017, the Government expects IRC to raise K400 million of additional tax in 2017.

Standardised Taxation Treatment of Dividend, Corporate Income Tax, Interest and Foreign Contractors across all sectors of the Economy

The 2017 Budget introduces measures to standardise the taxation treatment of dividends, interest and foreign contracts at 15% and corporate income tax (CIT) at 30% across all sectors for simplification, broadening the tax base and increasing efficiency.

Standardising Dividend Withholding Tax rate at 15 per cent

Companies are required to withhold tax on dividends and remit to IRC. The dividend withholding tax (DWT) rate varies across different sectors. Non-resource companies and mining companies attract 17% and 10% respectively, while petroleum companies are exempt.

Currently, some petroleum companies attract a CIT rate of 50%, others 45% while few attract 30% including PNG LNG - however, no DWT is applied. This means the effective rate of company tax for petroleum companies, may range from as high as 50%, to as low as 30%, whereas for non-resource and mining companies CIT rates are 42% and 37%. The Government is concerned that this reflects inconsistent tax treatment in one sector compared to other sectors.

For consistency, the Government is introducing a single rate of 15% for DWT across all sectors. As a result, the current non-resource companies DWT rate of 17% will reduce to 15%. In addition, the mining DWT will increase from the current 10% to 15% whilst petroleum and gas companies will increase to 15%. This measure will apply to all resource projects except those with stability clauses.

This measure is expected to reduce DWT collections in the non-resource sector by K6m in 2017. However, overall this measure is expected to have a positive impact in the medium to long term. It will come into effect on 1 January 2017.

Also, DWT will no longer apply to dividends paid to resident companies. DWT is only required to be withheld on dividends paid to resident individuals, resident trust estates and non-resident persons.

Standardising Corporate Income Tax at 30%

As noted above, different tax rates apply to different sectors. Most oil fields attract a CIT rate of 30%, but are not subject to DWT. The Government's objective to standardise tax treatment on dividend is to ensure all companies now pay DWT.

For the objective of broader simplification and harmonisation, the Government has reduced the CIT for all petroleum companies to 30%, to align with the effective corporate tax rate of mining and non-resource companies.

This measure is expected to reduce revenue from the petroleum sector by K2 million in 2017 and will come into effect on 1 January 2017.

Removal of Exemption from Interest Withholding Tax for Foreign Lenders Lending to Resource Companies

Currently interest derived by a non-resident lender from a company engaged in mining, petroleum or gas operations in PNG is exempt from income tax and interest withholding tax in PNG. This exemption is now repealed.

Foreign Contractor Withholding Tax (FCWT) to flat 15 per cent rate

The FCWT applies under Division 14A of the Income Tax Act 1959 (ITA) when a non-resident contractor is engaged by a PNG resident to perform a contract for prescribed purposes such as construction, installation, or consultancy services. The tax is currently levied based on a deemed rate of return of 25% of the gross value of the contract, which is taxed at the non-resident rate of 48%, resulting in an effective tax rate of 12%.

The 2017 Budget introduces a final FCWT at the rate of 15% with the legislative design no longer linked to the non-resident corporate tax rate. The Government notes that this is necessary to simplify administration and to give more certainty to the taxpayer on the taxable amount. These contractors will no longer be able to file an income tax return. Penalties for non-compliance have also been increased.

The measure is expected to have a positive impact on Government revenue and will come into effect on 1 January 2017.

Revamped Additional Profits Tax (APT)

APT is a tax payable in addition to the company income tax. The APT or resource rent taxation was developed to capture some of the super profits (the profit that is above the average rate of return) of resource companies. APT applies on the basis that resource companies exploit a non-renewable resource and although resource developers are entitled to a reasonable return on their investment, reflecting the substantial risks inherent in exploration and development, the Government considers that it should have the right to take a share of any extraordinary profits resulting from the operations.

In this budget, the Government introduces a revamped APT that will apply to all resource projects (ie not only designated gas projects). Under the revamped APT, the hurdle rate will be a flat nominal rate of 15%, and an APT rate of 30%. This measure intends to simplify administration, ensure a level playing field across the resource sector and ensure a fair return to the people of PNG.

This measure will apply to all resource projects except those with Fiscal Stability clauses. This measure is aimed at achieving progressiveness in the tax system to ensure PNG derives maximum benefits from its mining and petroleum wealth and is expected to be revenue positive in the long term and will come into effect on 1 January 2017.

Removal of Double Deduction for Minerals Exploration Expenses

The 2017 Budget will repeal the double deduction provision to increase the tax base and align the taxation treatment to the petroleum sector. Exploration expenditure for petroleum companies is deducted using a 25% declining balance method or a straight line depreciation. There is, however, a limitation that the deduction for exploration cannot cause a tax loss.

In some cases certain exploration expenditure for mining companies may qualify for double deductions. Currently the double deduction incentives only apply in the mining sector and not in the petroleum sector. This incentive in mining projects has the effect of reducing the corporate income tax paid by the mining companies and provides a 30% subsidy on the double deducted amount.

The Government notes that repealing this provision will ensure a level playing field across the resource sector, simplify administration and increase efficiency.

This measure is expected to have a positive impact on Government revenue in the medium to long term and it will come into effect on 1 January 2017.

Increasing the Taxable Component Of Employer Provided Housing Benefit

The 2017 Budget will adjust the prescribed taxable component of the employer provided housing benefit. It will create two additional tiers for Up Market Cost House & Very High Cost House and will fully tax Offshore employer provided housing (refer the table below). This is to strike a balance between encouraging and supporting employers who provide accommodation to employees, and ensuring fairness to all taxpayers, including those that do not benefit from employer provided housing. In the Government's view, the appreciation of housing costs has provided a large and growing tax subsidy to employees who receive free housing from their employer, but particularly to high income earners.

Proposed fortnightly prescribed value for taxing employer provided accommodation

Type of Housing	AREA 1	AREA 2	AREA 3
Very high cost house or flat (weekly rent K5,001 and above)	K2,500.00	K1,500.00	K0.00
Up-market cost house or flat (weekly rent from K3,001 to K5,000)	K1,500.00	K1,000.00	K0.00
High cost house or flat (weekly rent above K1,000 but less than K3,000)	K700.00	K500.00	K0.00
Medium cost house or flat (weekly rent K300 – K1,000)	K400.00	K300.00	K0.00
Low cost house or flat (weekly rent below K300)	K160.00	K150.00	K0.00
Mess/barracks	K60.00	K50.00	K0.00
Government mess/barracks	K7.00	K7.00	K0.00
Employees in approved low cost housing scheme	K0.00	K0.00	K0.00

Source: Department of Treasury

Note: Area 1- Goroka, Lae, Madang, Mt Hagen, Port Moresby, Kokopo, Alotau & Kimbe
Area 2- Bulolo, Daru, Kainantu, Kavieng, Kerema, Kiunga, Kundiawa, Lorengau, Mendi, Popondetta, Pogera, Rabaul, Tabubil, Vanimo, Wabag, Wau, Wewak, Buka, Arawa & Lihir
Area 3- any place in Papua New Guinea not included in Area 1 and 2.

This measure is expected to increase the Government revenue by K6 million in 2017 and is expected to come into effect on 1 January 2017.

Implementation of the Minimum Standards – Base Erosion Profit Shifting (BEPS) Action 13 Transfer Pricing and Country by Country Reporting

The objective of PNG's transfer pricing provisions are to counter "non-arm's length transfer pricing" or "international profit shifting arrangements" which may have adverse tax implications for PNG's revenue. They also provide a mechanism by which PNG adopts an arm's length principle for taxation purposes as the basis for ensuring that PNG receives its fair share of tax by adjusting profits under comparable circumstances.

The ITA requires taxpayers to keep proper records relating to their transfer pricing. However, there is currently no specific statutory requirement to prepare and maintain transfer pricing documentation. IRC at present collects transfer pricing information through Schedule 7 - International Dealings Schedule (IDS).

The Government acknowledges that BEPS issue is significant and through responsible agencies needs to have in place the most appropriate mechanisms to counter transfer pricing and protect PNG tax revenue. It is important for PNG to adopt the most up to date reporting standards and systems like those of other member nations.

The implementation of the revised OECD reporting standards will allow the IRC to have better information and access to information through automatic exchange of reports by multi-national enterprises and lead to increased tax revenue through tax audits and voluntary compliance.

This measure is expected to strengthen the revenue base and save more revenue in the medium to long term and will come into effect on 1 January 2017.

Benefits from Exports of Unprocessed Logs

The Government is changing the 28.5% fixed rate applied on export of unprocessed old-growth logs and reverting to progressive export duty rates applied prior to 2007. This measure should encourage downstream processing, capture resource rent from high valued species of old-growth logs and simplify administration.

This measure expects to increase Government's revenue by K88 million and will come into effect on 1 January 2017.

Increased Alcohol and Tobacco Excise

The 2017 Budget will increase the alcohol indexation cap from 2.5% to a fixed rate of 5% biannually while the tobacco excise base rates will have a one-off increase. Tobacco excise is currently indexed at fixed 5% biannually. The Government will apply a one-off increase of 15% on the tobacco excise effective base rate from 1 December 2016. The Minister acknowledges that these changes may result in people resorting to cheap illicit alcohol and tobacco but it will set up a Task Force to combat such illicit activities in 2017.

This measure is expected to raise K19 million from alcohol and K24 million from tobacco. This measure will come into effect on 1 December 2016 and 1 January 2017 for alcohol and tobacco excise increases respectively.

Other Tax Changes

A number of other tax changes are being introduced as follows:

- redistribute the gross profits of gaming machines to increase the Government share via the Consolidated Revenue Fund (CRF) from 46% to 55%.
- improving road network and maintaining efficient road system by increasing diesel excise
- merging bookmaker's stamp duty with bookmaker's turnover tax (BTT) and increases BTT to 15% to simplify administration and encourage individual spending in productive areas.
- increase departure tax from K30 to K114.

Minor Technical and Administrative Amendments

The 2017 Budget also introduces minor technical and administrative amendments to improve equity, efficiency, simplify administration, correct typographical errors and correct out-dated referencing and to clarify the law for ease of administration. The measures are also intended to help modernise the Internal Revenue Commission and improve its administration.

Corporate and Personal Tax Rates

There has been no change to the general corporate income tax rates of 30% for residents and 48% for non-residents. There has also been no change to the personal tax rates that have applied from 1 July 2012.

Policy Development Area

The Government has noted that it will continue to review the TRC's recommendations in 2017 to introduce reforms for implementation in 2018 and beyond to contribute to a modern and efficient tax system.

The Government will assess the TRC's recommendations relating to Mining and Petroleum Taxation, Taxation Incentives, Capital Gains Taxation, and tax administration in 2017 for consideration in 2018 Budget and beyond. This will also include the review into the current Tariff reduction program and Non-tax fees and charges. In addition, the Government will continue to undertake reforms to ensure prudent fiscal management of Public Funds by the statutory bodies.

The PNG Budget commentary has been prepared to provide an overview of the general issues raised in the 2017 Budget. It does not cover exhaustively the subjects discussed. When specific issues occur in practice it is necessary to refer to the laws and regulations and to obtain appropriate professional advice.

While every care has been taken in the preparation of this publication, no warranty is given as to the correctness of the information it contains and no liability is accepted for any statement or opinion, nor for any error or omission.

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