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ISSUES PAPER

THE ROAD FROM THE 2019 NATIONAL BUDGET TO THE 2020 NATIONAL BUDGET AND THE ECONOMIC IMPLICATIONS

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Abstract

This paper provides an analysis of the progression from the 2019 National Budget to the 2020 National Budget for Papua New Guinea (PNG) and its economic implications, using information from relevant budget documents and related literature.

The paper recommends six areas of intervention, including:

- taking effective control of the personnel emoluments' blowouts because the continuation of such blowouts suggests a loss of control of the deficit;
- ensuring stability in the capital budget going forward to grow the economy;
- promoting job creation and broad-based economic growth to broaden the tax base and increase government revenue;
- making the resources sector work better in terms of its contribution to government revenue and translating these revenues to grow the non-resource sector for sustainable economic growth and human development;
- addressing the debt burden issue by promoting broad-based economic growth and increasing the government's share of revenues from economic growth; and
- addressing the foreign exchange shortage issue by making it mandatory for big resource companies in PNG to bring onshore, foreign exchange earnings and not park them in offshore foreign currency accounts, and promoting SME development for exporting and import-substitution.

The success of the above interventions will depend on sound policies that are based on strong theoretical foundations and empirical evidence generated by research and analysis.

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By Osborne Ogis Sanida

Introduction

From an economic perspective, a government has three main functions: revenue-raising and spending, borrowing and lending, and buying and selling (Mannur, 1995). In performing these functions, a government is expected to act in such a way as to improve the welfare of the people it purports to serve.

This paper provides an analysis of the progression from the 2019 National Budget to the 2020 National Budget for Papua New Guinea (PNG) and the economic implications. The main aim is to highlight the changes in key economic variables and the economic implications going forward in light of the expected functions of government stated above.

Data and information sources, and presentation

The data used in this paper were sourced from the 2019 Budget documents, the 2019 Mid-Year Economic and Fiscal Outlook (MYEFO), the 2019 Supplementary Budget documents, the 2020 Budget documents, and other relevant literature. The analysis focuses on the changes in and implications of key fiscal and economic variables, including total revenues and grants, total expenditure and net lending, budget surplus/deficit, surplus/deficit as a percentage of gross domestic product (GDP),[1] total public (government) debt, debt-to-GDP ratio (%), and GDP.

The analysis in the paper uses both data taken directly from the relevant budget-related documents and statistics derived from the source data, which will be presented in Figures 1 and 2, and in the Appendix.

Political-economy context

The 2019 National Budget was handed down in November 2018 under the O'Neil-Abel government (see Department of Treasury, 2018) under the theme of 'Building a broader based economy' (Abel, 2018, p. 13). The 2019 Budget was also framed within the 'Government's Medium-Term Fiscal Strategy (MTFS 2018–2022) to raise revenue, reduce expenditure and achieve a debt to GDP ratio of 30 percent by 2022 in compliance with the *Fiscal Responsibility Act*' (Department of Treasury, 2019a, p. 1).

After the passage of the 2019 Budget, the O'Neil-Abel government only served a further five months (i.e. up to April 2019) before being replaced by the Marape-Steven government in May 2019. Given the political developments during the five months after the 2019 Budget was handed down, it would have been a challenging time for the O'Neil-Abel government to implement the 2019 Budget during those five months.

The new government embarked on consultations with the key stakeholders in order to chart a way forward. From a budget perspective, the Hon. Sam Basil was appointed as the new Treasury minister. The new minister was in the post for a short while, where he oversaw the publication of the 2019 MYEFO Report, which was released in July 2019 (Department of Treasury, 2019a). Effectively, the MYEFO was presented by the new government to report on the work of the previous government and make revisions on the implementation of the 2019 Budget for the rest of the year.

The MYEFO Report is a requirement under the *Fiscal Responsibility Act 2006* (FRA), whose purpose is 'to provide updated fiscal information to allow public assessment of the government's performance against the fiscal strategy set out in its budget' (Independent State of Papua New Guinea, 2006, p. 4).

On 11 October 2019, the Marape-Steven government handed down the 2019 Supplementary Budget (see Department of Treasury, 2019b) through the new Treasurer, the Hon. Ian Ling-Stuckey (who had replaced the Hon. Sam Basil earlier in a Cabinet reshuffle).[2] The Supplementary Budget was framed on the premise of 'Taking back our country from the road to self-destruction and on to a path of sustainable inclusive growth where no child is left behind' (Ling-Stuckey 2019a,

[1] GDP is the market value of all final goods and services produced within an economy within a given period of time, usually one year.

[2] Hon. Ian Ling-Stucky was appointed from the Opposition. His appointment led to the Hon. Sam Basil being moved to the National Planning Ministry.

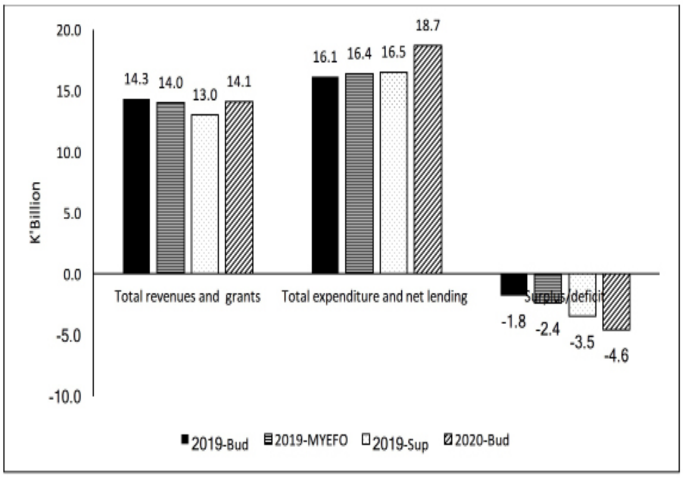
p. 3), echoing the sentiments of Prime Minister Marape. As per the Treasurer's Budget Statement, the final figures of the Supplementary Budget were arrived at after taking into account a due diligence exercise by the Treasury team and verification by a team from the International Monetary Fund (IMF), (Ling-Stuckey, 2019b).

Just over a month after the passage of the Supplementary Budget, the 2020 National Budget was handed down on 28 November 2019 with the theme of 'Take Back PNG' (see Department of Treasury, 2019c, 2019d, 2019e, 2019f; Ling-Stuckey, 2019c; Samuel, 2019; Vele, 2019). Compared to previous budgets since Independence, the projected 2020 total expenditure of K18.7 billion is the largest. The projected deficit of K4.6 billion is also the largest since Independence.

Revenue, expenses and deficit/surplus

The government has a responsibility to spend on goods and services that the country requires, and it needs to raise the funding required via taxation or borrowing. The need for a national budget is based on Section 209(2) of the National Constitution (Independent State of Papua New Guinea, 1975). Figure 1 shows the estimates of revenues, expenses and deficit/surplus from the 2019 Budget to the 2020 Budget.

Figure 1: Budget estimates, 2019 Budget to 2020 Budget.



Note: Data sourced from 2019 Budget documents, 2019 MYEFO Report, 2019 Supplementary Budget, and 2020 Budget documents (Department of Treasury).

The budget estimates for the four budget scenarios are represented in Figure 1 as follows: "2019-Bud" columns for the original 2019 Budget estimates; "2019-MYEFO" columns for the budget estimates under the MYEFO Report; "2019-Sup" columns for the budget estimates under the 2019 Supplementary Budget; and "2020-Bud" columns for the estimates under the 2020 Budget. The analysis is as follows:

Original 2019 Budget Estimates

Under the original 2019 Budget (Department of Treasury, 2018), total expenditure and net lending was estimated at K16.1 billion and total revenue and grants at K14.3 billion. Given this, a budget deficit of K1.8 billion (2.0% of GDP estimated at K88.7 billion) was projected for 2019. Total debt was projected to be about K27.3 billion (or 30.8% of GDP).

Budget Estimates under the 2019 MYEFO Report

Under the 2019 MYEFO Report (Department of Treasury, 2019a), total revenue projection for 2019 was revised downwards by 2.1 percent to K14 billion. The key factors associated with the projected fall in revenue are: (1) shortfall in company income tax; (2) moderation in the Mining and Petroleum Tax; and (3) shortfall in revenues from the Public Money Management Regularisation (PMMR) targets.

On the other hand, the total expenditure and net lending was revised upwards by 1.9 percent to K16.4 billion. The projected increase is due to the projected overruns in personnel emoluments (by K188.2 million) and debt interest payments (K61.1 million).

As a result of the projected fall in revenue and increase in expenditure, the projected budget deficit will increase by 33.3 percent from K1.8 billion (under the original 2019 budget) to K2.4 billion under the MYEFO.

2019 Supplementary Budget Estimates

The 2019 Supplementary Budget under the Marape-Steven Government was framed mainly by reference to the original 2019 Budget framed by the O'Neil-Abel Government. Treasurer Ling-Stuckey justified the need to revise the 2019 Budget through the Supplementary Budget by using an analogy from the perspective of a business person. That is, 'essentially, he has come into a new business and found out that the costs have been underestimated by K1,874.7 million. Sales were not going well so there is a need to cut expenditures' (Ling-Stuckey, 2019b, p.2). To this effect, under the Supplementary Budget, expenditure was cut by K1,482.1 million, which is elaborated as follows:

Under the original 2019 Budget, total expenditure and net lending (in millions of Kina) was estimated at K16,133.5 million. As per the Treasurer's statements (see Ling-Stuckey 2019a and Ling-Stuckey 2019b), based on the due diligence exercise, this figure was supposedly underestimated by K1,874.7 million; hence, the expenditure was revised upwards by K1,874.7 in order to address the underestimation or unbudgeted costs under the original 2019 budget (i.e. from the previous government). The underestimated cost (or cost overruns) comprised the following:

- personnel emoluments overruns (by 46%);
- capital arrears, rentals and utilities (28%);
- debt interest servicing (6%);
- economic projects (5%);
- disaster funds (5%);
- goods and services increases (4%);
- missing road links expenses (3%); and
- Bougainville infrastructure (3%).

The increase in expenses would have meant that the new total expenditure and lending would be K18,008.2 million (i.e. K16,133.5 million + K1,874.7 million) or K18 billion. With this new expenditure and the original 2019 projected total revenue of K14,266.8 million (or K14.3 billion), the new deficit would have been K3,735.3 million (or K3.7 billion). However, the government made the decision to cut expenses in order to manage the deficit, per the Treasurer's statement (Ling-Stuckey 2019b). This cut amounted to K1,482.1 million, which comprised a 73 percent reduction (or K1,082.1 million) in capital expenditure and a 27 percent cut (or K400 million) to operational expenditure. Given the cut, the revised total expenditure and net lending under the Supplementary Budget was K16,526.1 million (i.e. K18,008.2 million minus K1,482.1 million) or K16.5 billion. This action meant that the actual increase in expenditure under the Supplementary Budget (from the original 2019 Budget) was only K392.6 million (i.e. K16,526.1 million minus K16,133.5 million). This represents an increase of 2.4 percent.

On the revenue side, the Supplementary Budget projected a total revenue of K13 billion. This new total revenue is 7.1 percent lower than the MYEFO estimate and 9.1 percent lower than the original 2019 Budget (K14.3 billion). So, under the Supplementary Budget, given the projected total expenditure of K16.5 billion and total revenue of K13 billion, the revised deficit is K3.5 billion. This revised deficit is 45.8 percent higher than the MYEFO estimate and about 94.4 percent higher than the original 2019 Budget.

According to one of the dailies, the Opposition, through the Shadow Treasurer, blamed the Government for not basing the Supplementary Budget figures on the MYEFO, which it sees as a first (Kuku, 2019). However, the Government defended the Supplementary Budget as necessary to repair the original 2019 budget.

As can be deduced from the above analysis, the implementation of the 2019 Budget has been challenging given the political developments and the changes in projections from the original budget to the MYEFO and the Supplementary Budget. The changes in numbers under the Supplementary Budget are attributed to the purported due diligence exercise by the Treasury team and the IMF team. The due diligence exercise is worthwhile if it leads to better management of fiscal policy. For example, the underestimation of personnel emoluments is a serious issue that can put great pressure on the budget because personnel emoluments are a large component of the budget.

The 2020 Budget Estimates: Basis and components of the expenditure plan

According to the 2020 Budget Strategy Paper (Department of Treasury, 2019c), the 2020 expenditure plan is driven by the following key areas: First, to pay off arrears that have been accumulating in recent years (some of these have been highlighted above in the discussion on the Supplementary Budget). Second, the need to increase the development budget by 10 percent per annum as the basis for growing the economy. Third, the need to control and manage personnel emoluments expenditure and arrears, which has been an ongoing budget issue. Fourth, the need to clear the 3 percent pay rise arrears while simultaneously holding off further salary and wage negotiations in order to establish a real baseline for the personnel emoluments expenditure for future budgets. Finally, institutionalising the 'living within our means' as a key performance indicator (KPI) for all heads of state departments, agencies and enterprises to control spending.

Based on the above strategies, the 2020 expenditure plan or estimate is K18.7 billion comprising 68 percent for operational expenditure (i.e. K12.7 billion) and 32 percent for capital expenditure (K6.0 billion). The Operational Budget comprises (see Vele, 2019):

- Compensation for employees: K5,672.8 million (44.5% of Operational Budget);
- Goods and services: K3,821.6 million (30.0% of Operational Budget);
- Function grants: K508.7 million (4.0% of Operational Budget);
- Debt interest servicing: K2,156.9 (16.9% of Operational Budget);[3] and
- GST and licensed bookmakers' tax: K586.4 million (4.6% of Operational Budget).

[3] Out of this total, 73 percent is for domestic interest payment, 27 percent is for external interest payment, and 1 percent is for borrowing related charges.

The K6.0 billion capital budget constitutes the following (see Samuel, 2019):

- Public Investment Projects (PIPs): K2,573.4 (43.0% of capital budget);
- Loan drawdowns: K1,365 million (22.8% of capital budget);
- Services Improvement Programs (SIPs): K1,110 million (18.6% of capital budget); and
- Donor-funded projects: K932.1 million (15.6% of capital budget).

2020 Budget: Revenues, grants, deficit and financing plan

The ability of a government to fund its expenditure depends on its ability to raise the revenue through taxation and other sources such as grants. If it can raise the revenues fully, then it does not need to borrow. However, when a government cannot raise the full amount of the revenue required to fund the budget, it has to borrow to finance the gap (i.e. deficit). In the recent past, this has been the situation for PNG, where deficit-financing has been the norm. The opposite case, where revenues exceed expenditure (i.e. budget surplus), is a rarity in PNG.

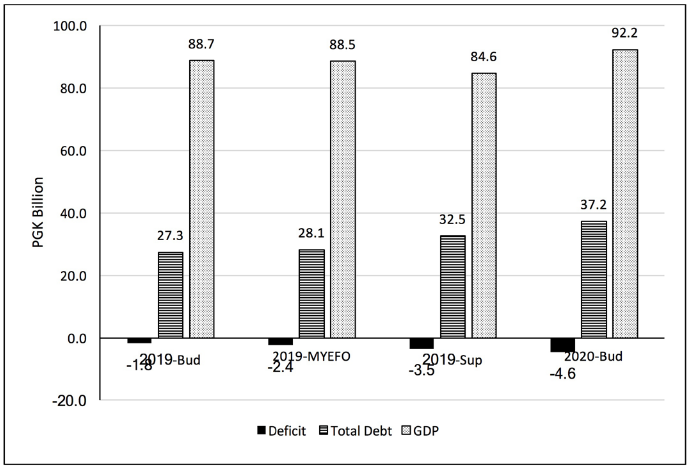
For 2020, the PNG government plans to spend K18.7 billion, but it can only fund 75.4 percent of that amount (or K14.1 billion) from projected revenue and grants. Of the K14.1 billion projected total revenue, tax revenue is expected to make up 79.4 percent (K11.2 billion), followed by 14.2 percent (or K2.0 billion) from other revenues, and 6.4 percent (or K0.9 billion) from donor grants. In terms of specific revenue sources, the top six expected sources of government revenue (making up 75.2% of total revenue) are personal income tax (22.7% of total revenue or K3.2 billion); Goods and Services Tax (GST) revenue (15.6% of total revenue or K2.2 billon); company income tax (14.9% of total revenue or K2.1 billion); excise duty (8.5% of total revenue or K1.2 billion); dividends (7.8% of total revenue or K1.1 billion); and revenues under the PMMR (5.7% of total revenue or K0.8 billion).[4]

Because the government can only fund 75.4 percent of the Budget from revenue and grants, it has to borrow the remaining 24.6 percent (or K4.6 billion), which is the budget deficit. To finance the deficit, the government intends to borrow 84.8 percent of it (or about K3.9 billion) from external sources and the remaining 15.2 percent (or about K0.7 billion) from domestic sources. External financing will constitute concessional loans (26%), commercial loans (2%), and extraordinary financing (76%). Domestic financing will comprise Treasury Bills and bonds (inscribed stocks) that will be managed by the Bank of Papua New Guinea (BPNG) on behalf of the government. These government securities are financial debt instruments used to raise funds to finance budget deficits. A Treasury Bill is a short-term financial debt instrument available to the general public, while inscribed stocks is a government bond that is a medium to longer term investment that is currently only available to registered bidders (Bank of Papua New Guinea, 2020a).

Deficits, debt and GDP

As stated earlier, the projected 2020 total expenditure of K18.7 billion is the largest since Independence (1975), and with a projected total revenue of K14.1 billion, the deficit of K4.6 billion is also the largest since Independence. Historically, the PNG National Budget has been centred on deficit financing where borrowings had to be made to finance the shortfalls in tax revenues and grants in order to finance the budget. This, of course, implies that the total debt stock has grown over the years. In this section, we highlight the progression of the deficit from the 2019 Budget to the 2020 Budget, using the data shown in Figure 2.

Figure 2. Deficit, debt and GDP, 2019 Budget to 2020 Budget.



Note: Data sourced from 2019 Budget documents, 2019 MYEFO Report, 2019 Supplementary Budget, and 2020 Budget documents (Department of Treasury).

The column labels in Figure 2 for the four budget estimates are as follows: "2019-Bud" for the original 2019 Budget estimates; "2019-MYEFO" for the budget estimates under the MYEFO Report; "2019-Sup" for the budget estimates under the 2019 Supplementary Budget; and "2020-Bud" for the estimates under the 2020 Budget.

[4] Under the PMMR Act, state agencies generating revenues are expected to remit 90 percent of monies made to consolidated revenue of the Department of Treasury.

Under the original 2019 Budget, a deficit of K1.8 billion was projected that contributed to increasing the debt stock, which was estimated at K27.3 billion. This is 30.8 percent of GDP estimated at K88.7 billion. This debt level was within the 35 percent debt-to-GDP ratio limit under the FRA at that time.

When the budget was revised under the MYEFO Report, the deficit was K2.4 billion (a 33.3% increase from the original 2019 deficit estimate). As a result, the total debt level estimate increased to K28.1 billion, which was 31.8 percent of GDP (estimated at K88.5 billion). This debt level was again within the 35 percent debt-to-GDP ratio limit under the FRA.

Under the 2019 Supplementary Budget, the new government made the decision to amend the debt-to-GDP ratio limit from 35 percent to 45 percent, thereby amending the FRA (see Department of Treasury, 2019d, p. 5). The Debt-to-GDP ratio limit will be reduced to 40 percent in five years and to 35 percent in 10 years. The FRA amendments is expected to allow flexibility for the government to allow budget repair by raising cheap and concessional lending, and builds commitment to begin fiscal consolidation over the medium term' (see Department of Treasury, 2019d, p. 5).

The budget deficit of K3.5 billion under the Supplementary Budget was 94.4 percent higher than the original 2019 estimate and 45.8 percent higher than the MYEFO estimate. The increase contributed to a higher debt stock of K32.5 billion, which is 38.4 percent of GDP (estimated at K84.6 billion).

The 2020 Budget saw the biggest budget deficit (K4.6 billion), which contributed to the largest debt stock level of K37.2 billion or 40.3 percent of the estimated GDP (K92.2 billion). This situation, although legal under the revised debt-to-GDP ratio limit (45%), can have adverse economic implications if the increasing debt stock is not managed well and leads to unsustainable fiscal outcomes. On a positive note, if the borrowings are in the form of concessional loans that are used to finance public investments to raise GDP, improve developmental outcomes, and return public finances to a path of fiscal sustainability, then the higher debt-to-GDP ratio would be warranted (Chand, 2016).

Foreign exchange rate and reserves

PNG is a small open economy, highly dependent on international trade and foreign investment and aid. Given this, PNG's economic and financial transactions with the rest of the world are affected by the changes in the exchange rate and level of foreign exchange reserves.

A key issue mentioned in the budgets is the problem of foreign exchange shortage, especially since restrictions were imposed by the Central Bank in 2014 (see Department of Treasury, 2018, 2019a, 2019d). As an import-dependent economy, the restrictions have had serious adverse impacts on the operations of businesses, and individuals and government who all depend on imports.

The foreign exchange shortage problem is a paradox given that PNG is facing the shortages in the midst of resource development booms led by the PNG LNG Project. So, what is the problem then? Understanding the role of the exchange rate and its relation to the foreign exchange reserves brings clarity to the problem and how it can be managed/addressed.

The Kina exchange rate is the price of Kina in terms of other currencies (e.g. PGK1 = USD0.30).[5] A change in the exchange rate has a dual effect on those involved in international financial transactions. That is, it hurts some while benefitting others, depending on the direction of the change. Those directly affected by the exchange rate include importers, exporters, cross-border investors, foreign aid donors and recipients, and international travellers. In an open economy like PNG, the exchange rate also has externality effects through price and quantity changes brought about by the direct impacts of the changes in the exchange rate.

When the Kina weakens (or depreciates),[6] it favours exporters, foreign tourists coming to PNG, foreign investment inflows and foreign aid inflows, because a given amount of foreign currency will buy more of the Kina than before. The same movement of the Kina exchange rate (i.e. depreciation) will hurt importers, PNG tourists going abroad, investment outflows, and PNG aid sent abroad, because a given amount of Kina will buy less foreign currency than before. The reverse impact is true when the Kina strengthens (or appreciates).[7] That is, exporters, foreign tourists, foreign investment inflows and foreign aid inflows will be hurt because a given amount of foreign currency will buy less Kina than before. On the other hand, the appreciation will benefit importers, PNG tourists going abroad, investment outflows and PNG aid sent abroad because a given amount of Kina will buy more foreign currency.

Currently, the Kina is weak against most currencies, as evidenced by the falling Total Weighted Index (Bank of Papua New Guinea, 2020b), so the weaker Kina favours exporters,

[5] For example, if you exchange K100.00 for USD at the foreign exchange dealer, you will only get USD30.00.
[6] For example, when the PGK exchange rate changes from PGK1 = USD0.30 to PGK1 = USD0.25.
[7] For example, when the PGK exchange rate changes from PGK1 = USD0.30 to PGK1 = USD0.35.

foreign tourists in PNG, foreign investment inflows and foreign aid inflows, but hurts importers, PNG tourists going abroad, investment outflows and PNG aid sent abroad.
The Kina exchange rate and its movements have an impact on the level of foreign exchange reserves and the subsequent effects on the economy. Given the weaker Kina and the expected positive impacts on increasing foreign currency flows into the PNG economy, one would expect that the level of foreign reserves should be high. However, this is not the case, as evidenced by the restrictions on foreign reserves. The obvious reason is that there is not enough foreign currency flowing into the economy. But why is this the case?

One of the factors is the low commodity prices with the result that foreign exchange earnings from exports have been less than expected, in particular in the case of the PNG LNG Project (Odhuno, Ayres, Sanida and Yala 2016). Making the situation more dire, is the concern that over the years, governments have signed agreements allowing mining, petroleum and gas companies to keep their foreign exchange earnings in offshore foreign currency accounts (Odhuno, et al 2016). This means that not all the reported export earnings in PNG's balance of payments account flow as foreign exchange into the economy, thus worsening the foreign currency shortage problem.

The paradox of foreign exchange shortages requires a change in mindset and strategy. That is, the Government should make it a requirement for new large resource development projects/companies to bring a sizeable portion of export earnings into the economy and not park all export earnings in offshore foreign currency accounts. For the current 'most favoured companies' that keep offshore foreign currency accounts, the Government should negotiate the deals with them to require that after servicing offshore loan commitments, the balances/surpluses be brought into the PNG economy, rather than keeping them in offshore foreign currency accounts (Odhuno, et al 2016). Given the nature of land ownership in PNG and governance structure, every resource that has been exported is owned by the people, either directly or through the State, hence every deal that is made between the Government and resource developers must have the welfare of the people at the centre, if real development outcomes for the people are to be realised.

In addition to the role of large resource development projects in addressing the foreign reserves shortage issue on the economy, the role of small-to-medium enterprise (SMEs) is also important. That is, there is a need to promote exports and reduce imports (where applicable) by promoting SME development in the production of goods and services to serve both the export markets (earning foreign exchange) and the domestic market (avoiding foreign exchange issues). The effective implementation of the National SME Policy is important in this regard.

Some key economic implications

In light of the above discussion, six key economic implications or interventions are discussed here, particularly from the context of budgeting that promotes economic growth and development.

Addressing the personnel emoluments issue

The analysis on the operational budget for 2020 shows that personnel emoluments is the biggest component, constituting almost half of the operational budget (i.e. 44.5% or K5.7 billion). Almost K1 billion of that amount is for paying off arrears on salaries and wages (Department of Treasury, 2019d). The decision by the government to pay off these arrears will contribute to increasing total expenditure and subsequently the deficit and debt burden (from borrowing), which the taxpayers have to repay. However, on a positive note the payment off arrears will reduce the Government's obligation on such payments going forward and also contributes to increasing demand for goods and services for business through increased consumer spending. Beyond paying off the arrears, what needs to be done is that measures must be taken to ensure that such arrears do not recur and that any wage increases must be tied to productivity increases. The plan by the government to conduct verification of arrears before paying is another step in the right direction. If the salary and wage costs continue to blow out this will have a detrimental impact on the management of the deficit and debt levels.

Need for stability in the capital budget

The effective implementation of the capital budget is vital for growing the economy. However, it is regrettable to note that experience has shown that normally the capital budget gets a big cut when there is a blowout to the operational budget. For example, under the 2019 Supplementary Budget, capital expenditure was cut by 73 percent. The lesson is that there must be prudent management of operational expenditure so that the capital budget is not diverted to meet shortfalls in the operational budget but is left to be spent on much-needed infrastructure and other projects to grow the economy. On a positive note, the government's plan to increase the capital budget by 10 percent over time is a step in the right direction. The challenge is to maintain stability in the capital budget.

Need for increased job creation

Budget appropriations and actual numbers indicate that personal income tax is the foundation for government revenue in PNG. This implies two things: First is that job creation plays an important role, not only for creating incomes for people, but also income to the government through taxes. Given that in PNG the majority of the people live in rural areas and without paid employment, credit must be given to employers who employ the minority of the population whose tax is the main source of revenue for government. Second, as a direct tax, personal income tax can be relatively easy to collect and is less susceptible to tax evasion and avoidance because it is deducted by the employer and paid directly to the Internal Revenue Commission (IRC). These two observations explain why employment creation is important, because it not only creates incomes for people but also contributes to broadening the tax base and government revenues. Once again, the growth of the SME sector and addressing the business constraints is vital if employment creation is to be enhanced.

Making the resources sector work better to increase government revenue

One important issue that emanates from the data for the 2020 Budget is that the mining and petroleum taxes are projected to make up only 3.7 percent of expected total revenue. This is a paradox given that the sector is a big contributor to economic growth but not as a source of government revenue. This brings forth the question of how best can the mining and petroleum sector contribute to revenues for government. There needs to be a change in strategy to ensure that the tax contribution to the government by the sector is increased to reflect the large magnitude of revenues the sector generates. The natural resources that are extracted and sold (e.g. LNG, gold, copper, nickel, oil) must be thought of as assets of the people of PNG and so as owners of the natural resources, the people must receive benefits (either directly or through the government) that reflect their ownership of the assets. In addition to the government increasing its revenues from the resources sector, it must also translate these revenues to grow the non-resource sector (e.g. agriculture, fisheries and manufacturing sector) for sustainable economic growth and human development.

Addressing the debt burden

Total public (Government) debt stock in PNG has accumulated over time and is expected to be K37.2 billion in 2020. The debt problem involves both the repayment of the principal and interest payments.

To address the rising debt burden, the fundamental action required is to grow the economy in order to generate revenues to pay off the debt. From a budget perspective, in order to grow the economy, the following are required:

- wise spending on PIPs to create an enabling environment for business and economic growth, which is the basis for increasing revenues to repay loans;
- given a predominantly rural-based population, the wise use of SIPs is important if development is to benefit the majority of the population as well as achieving broad-based economic growth, which will contribute to repaying loans; and
- targeted and effective use of aid monies to address the constraints to business startups and performance, especially in the context of SMEs to promote self-reliance and less reliance on foreign aid; for example, by addressing the key areas of economic infrastructure, access to land, raising skill levels, law and order issues, and access to micro credit.

Having emphasised the importance of growing the economy above, it is not a sufficient condition to addressing the rising debt burden because the economy may be growing but if the government does not get a big enough share from the growth of the economy, then it cannot reduce the debt burden. Given this, a second condition is required; that is, the government needs to increase its revenue streams (or share from economic growth) to be able to fund its operational expenses and also reduce its debt burden over time. If revenues cannot be increased, then more expenditure side management is needed to manage the deficits.

By a combination of measures to grow the economy and increase the Government's share from economic growth, the debt burden can be reduced and public finances can be returned to a path of fiscal sustainability.

Addressing the foreign reserves shortage issue

The budgets mention foreign exchange shortage as a key issue, especially in the context of PNG being an import-dependent economy. The foreign exchange shortages have had negative impacts on the operations of businesses, individuals and government, who depend on imports. As a price taker, PNG has no direct control on falling commodity prices that reduce foreign exchange earnings. However, through proper management of economic/business activities involving cross border financial transactions, the issue can be addressed. One is that the Government should institute laws/regulations to require that big resource projects/businesses that keep export earnings in offshore foreign currency accounts must transfer a sizable amount of foreign exchange earnings into PNG.

Another is to promote the activities of SMEs to engage in both exporting and import-substitution business in order to, respectively, generate export earnings and reduce reliance on imports.

Conclusion

With the largest projected expenditure (K18.7 billion) and deficit (K4.6 billion), the 2020 Budget sets a new record for PNG, in comparison to all previous budgets since Independence. These record figures have been arrived at through a transition from the 2019 Budget under the O'Neil-Abel government through to the 2020 Budget under the Marape-Steven government. As a budget under a new government, the 2020 Budget was appropriately framed to 'Take Back PNG', the catch-cry of the new government.

This paper has highlighted six areas that need to be addressed so that the Budget can make a real impact, not just for 2020 but also the years ahead. They include:

- addressing the personnel emoluments issue by not only paying off the arrears but also establishing effective mechanisms so that such arrears do not recur, because if the salary and wage costs continue to blow out, this will have a detrimental impact on the management of the deficit and debt levels;
- ensuring stability in the capital budget going forward (i.e. reducing the need to cut the capital budget during supplementary budgets) and increasing it going forward;
- promoting job creation, given that tax revenue is the main source of government revenue, and this can be made more prominent by creating more jobs (meaning more tax revenue) and achieving broad-based economic growth so that the tax base can be broadened to increase government revenue;
- making the resources sector work better in terms of its contribution to government revenue, given that the sector is a key driver of economic growth for which the government requires a fair return on the assets of the country in the resources that are produced and sold. In addition, the revenues from the resources sector must be translated into growing the non-resource sector for sustainable growth and human development;
- addressing the debt burden issue by not only encouraging broad-based economic growth but also putting in place strategies to increase the government's share of income from economic growth; and
- increasing the foreign exchange reserves by instituting laws/regulations whereby a sizable amount of foreign exchange that is earned by big resource companies as a result of economic activities undertaken in PNG must be brought onshore (and not parked in offshore foreign currency accounts); and also promoting SME development to increase exports and reduce reliance on imports via import-substitution.

The success of the above interventions will depend on sound policies that are based on strong theoretical foundations and empirical evidence generated by research and analysis.

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Appendix: Budget information on key variables, 2019 to 2020

Item	2019 Budget	2019 MYEFO	2019 Supple-mentary Budget	2020 Budget
Total revenues and grants (K'billion)	14.3	14.0	13.0	14.1
Total expenditure and net lending (K'billion)	16.1	16.4	16.5	18.7
Surplus (+)/ Deficit (-) (K'billion)	-1.8	-2.4	-3.5	-4.6
Deficit as % of GDP	-2.0%	-2.7%	-4.1%	-5.0%
Total debt (K'billion)	27.3	28.1	32.5	37.2
Debt-to-GDP ratio (%)	30.8%	31.8%	38.4%	40.3%
GDP (K'billion)	88.7	88.5	84.6	92.2

Note: Data sourced from 2019 Budget documents, 2019 MYEFO Report, 2019 Supplementary Budget, and 2020 Budget documents (Department of Treasury).

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