Executive Commentary

The 2015 PNG Budget is a continuation of the overall strategy of the two previous budgets and illustrates the Government's determination to stay the course with the agenda it has set. It continues the funding priorities of the major sectors it has identified, being in particular health, education and infrastructure development.

The Government’s hands on monitoring of its expenditure appears to have improved with the reprioritising of expenditure during the year and a substantially greater percentage of funds allocated actually being spent during the year. The Department of National Planning is reviewing its methods here with improved monitoring planned and introduction of a critical activity matrix.

The Government’s intention is to start winding back its deficits and return to a balanced budget by 2017, utilising its mining and petroleum income to achieve this. The Government is cognisant of its commitments to the South Pacific Games and the 2018 APEC conference but it remains to be seen whether it can cater for all the spending initiatives which have been discussed in recent times.

One also senses an increasing sense of frustration at the failure of its State Owned Enterprises (SOE’s) to deliver financial returns. No mention was made of the success or otherwise of the ten core principles outlined in developing a strategic framework for SOE’s announced in the 2013 Budget.

Also not mentioned was the current shortage of foreign exchange availability apparently due to the reluctance of exporters to repatriate foreign exchange. The Bank of PNG directives around foreign exchange rates appear to have given rise to this reluctance and the Bank does not appear to be using its own reserves to any extent to ease the shortage.

The Government foreshadowed a significant improvement in its debt position in large part through a sale of part of its LNG project interest to landowners. The timing of this appears to be optimistic if it is to be achieved.
The Government has made good on last year’s promise to conduct a wholesale review of its fiscal and taxation system and appears thus far to be handling this in an open and transparent way. Any resulting changes may be applicable 1 January 2016 and there remains a lot of work to be done.

In summary, this budget is strategically very similar to those preceding it and the Government appears to be across the issues in this strategy. There have clearly been improvements in process and these needs to continue to ensure these strategies are successful.

**Economic overview of budget**

**The 2015 PNG Budget**

**Overall Budget Strategy**

The 2015 PNG Budget is a deficit budget consistent with the Government’s strategy of the last two years. It was accompanied by a 2014 Supplementary Budget intended to reallocate expenditure to high priority areas and, as the Government said, prevent a blow out of expenditure over the remaining part of 2014.
The Government states that PNG is expected to grow some 15.5% in 2015 compared to the 21% it predicted some time ago. This is a reflection of the impact at the early start of the LNG project deliveries which drove the 2014 growth rate from an expected 5% to 8.4%.

The Government was pleased to point out the substantial reallocation to high priority areas of well over K1 billion and also that it was on track to meet major expenditure commitments for 2014. A number of high priority areas were listed where the percentage of the annual allocation spent for the year to date was between 60% and 91%. The Government said in overall terms it had expended some 73.3% of the 2014 budget allocation compared to a target of 83% year to date. One of the historical issues that has faced the PNG budget process from time to time has been the inability to actually spend funds allocated.

The theme of the 2015 Budget was “Building Our Nation and Providing Opportunities for our People” and the Government listed five Key priorities and they were:

- Enhancing opportunities for our people by building the foundation of the country while recognising the need for macro-economic stability;
- Promote the efficient and effective delivery of major projects;
- Increase direct funding to the provinces and districts;
- Continue to support policy priorities in health, education and infrastructure;
- Continue to strengthen the justice sector.

Total Revenue and Grants for 2015 are expected to total K13.927 billion while budgeted Total Expenditure is expected to be K16.199 billion leading to a deficit for 2015 of K2.272 billion. This amounts to 4.4% to GDP and the Government states it is a step to return the Government’s budget deficit to a balanced position by 2017. As described below the Government is also predicting a substantial improvement in its debt position to a ratio of debt to GDP of 27.8% in 2015, considerably better than the target of 35% originally set last year.

The Government is still clearly committed to supporting the pillars that it has identified in past budgets, being:

- Health
- Education
- Infrastructure development
- Increasing funding direct to the provinces and districts.

Officials even mentioned planning for the eventual introduction of old age and disability pensions.

As last year, the Government also identified increasing the efficiency of the public sector and its current review of the taxation system as priorities. The Budget contained no major tax changes of note so it is clearly awaiting the outcome of the taxation review.

**Specific issues of interest**

The Government stated that it is pleased with the progress of its fiscal and taxation review which is scheduled to complete in 2015. So far it has received a number of submissions, released three issues papers with another three to be released by year end and initiated two diagnostic reviews of PNG revenue collection agencies. The questions so far raised by the taxation review
committee indicate that the Government is prepared to consider substantial and significant changes to the Taxation system.

One issue that captured attention some time ago but comparatively little has been heard of since was the Government’s moves to establish a Sovereign Wealth Fund (SWF). The Government has reaffirmed its commitment to the establishment of a SWF and announced there will be further legislation going through Parliament refining the SWF concept. This will likely be quite extensive and require the engagement of outside legal assistance. The Government previously signalled the removal of the Development Fund from the SWF concept which will now comprise of a Stabilisation Fund and a Savings Fund. The Stabilisation Fund will manage the impact of fluctuating mining and petroleum revenues on the PNG economy while the Savings Fund will be held for long term investment for the benefit of current and future generations. The Government projects the taxation and other revenue from mining, oil and gas to be in the order of K7.5 billion for the 4 years commencing 2016. So clearly the SWF will be an important piece of its fiscal strategy.

The Trust Accounts held by the Government through which so much of the previous mining and petroleum income passed still warrant a mention. As time goes by, it does appear little will be done to investigate the outflow of funds from these accounts which total some K8.3 billion up to and including 2014. Some K329.4 million had been paid in this year by 30 September 2014 with an additional K778.0 million appropriated for the balance of 2014 and 2015.

Also of interest is the Government’s debt strategy. As highlighted above the Government proposes to reduce its debt from around 35% of GDP to 27.8% of GDP in 2015. It’s mechanism for doing this is via the sale of some 4.27% of the LNG project currently owned by National Petroleum Company PNG Ltd (NPCP) which would, according to the Government, amount to US$1.024 billion. This represents 25.75% of NPCP. Of the amount raised 50% is intended to be applied to expenditure priorities and 50% to debt reduction. In order to achieve this one would expect the Government will have to confirm landowner structures, assist them with the financing for the purchase of this asset and set up a governance structure to ensure the interest is effectively managed.

Apart from that the key elements of the debt strategy outlined by the Government include:

- Attempting to broaden its range of financing tools beyond Inscribed Stock, Treasury Bills and foreign currency denominated loans from development partners.
- Issuance of Inscribed Stock will return to more normal levels in 2015 with some K1.2 billion to be issued in 2015 compared to K1.92 billion issued in 2014.
- The Government will seek to rebalance its domestic debt portfolio to increase the weighting to longer term securities.
- The Government will work towards producing a policy around State Guarantees in 2015 which will provide guidance for the issuing of such guarantees. It was noted the State Guarantee over the LNG project of some US$2.7 billion was expected to be extinguished in 2015.
- It was also noted that the Government has an unfunded liability for superannuation contributions of K2.1 billion but there appears to be no specific schedule for repayment.

The Government has continued its practice of highlighting its economic indicator assumptions that it uses in framing its budget estimates. These are set out in the table below.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Act</td>
<td>Est</td>
<td>Proj</td>
<td>Proj</td>
<td>Proj</td>
<td>Proj</td>
<td>Proj</td>
<td>Proj</td>
</tr>
<tr>
<td><strong>ECONOMIC GROWTH</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total GDP</td>
<td>5.0</td>
<td>8.4</td>
<td>15.5</td>
<td>5.0</td>
<td>2.3</td>
<td>2.7</td>
<td>3.3</td>
</tr>
<tr>
<td>Non-Mining</td>
<td>4.9</td>
<td>2.2</td>
<td>4.0</td>
<td>3.9</td>
<td>3.7</td>
<td>3.9</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Inflation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average on Average (%)</td>
<td>5.0</td>
<td>5.9</td>
<td>5.5</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Dec on Dec (%)</td>
<td>2.9</td>
<td>8.3</td>
<td>4.4</td>
<td>5.0</td>
<td>4.3</td>
<td>7.2</td>
<td>5.2</td>
</tr>
<tr>
<td><strong>Interest rate</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Rate Facility (KFR)</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
</tr>
<tr>
<td>Inscribed Stock (3 year yield)</td>
<td>7.0</td>
<td>8.0</td>
<td>8.0</td>
<td>8.0</td>
<td>8.0</td>
<td>8.0</td>
<td>8.0</td>
</tr>
<tr>
<td><strong>Mineral Prices</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold (US$/oz)</td>
<td>1,411.1</td>
<td>1,273.1</td>
<td>1,277.2</td>
<td>1,297.7</td>
<td>1,311.1</td>
<td>1,330.5</td>
<td>1,370.4</td>
</tr>
<tr>
<td>Copper (US$/tonne)</td>
<td>7,331.5</td>
<td>6,904.2</td>
<td>6,946.6</td>
<td>7,037.8</td>
<td>7,143.9</td>
<td>7,162.9</td>
<td>7,197.9</td>
</tr>
<tr>
<td>Oil (Kutubu Crude: US$/barrel)</td>
<td>104.1</td>
<td>95.5</td>
<td>89.7</td>
<td>93.3</td>
<td>93.7</td>
<td>93.1</td>
<td>92.1</td>
</tr>
<tr>
<td>LNG (US$ per thousand cubic feet)</td>
<td>12.3</td>
<td>12.5</td>
<td>12.9</td>
<td>13.3</td>
<td>13.6</td>
<td>14.0</td>
<td></td>
</tr>
<tr>
<td>Condensate (US$/barrel)</td>
<td>84.9</td>
<td>87.0</td>
<td>89.2</td>
<td>91.4</td>
<td>93.7</td>
<td>96.0</td>
<td></td>
</tr>
<tr>
<td>Nickel (US$/tonne)</td>
<td>15,030</td>
<td>17,255</td>
<td>18,000</td>
<td>18,000</td>
<td>18,000</td>
<td>18,000</td>
<td>18,000</td>
</tr>
<tr>
<td>Cobalt (US$/tonne)</td>
<td>24,600</td>
<td>32,623</td>
<td>30,000</td>
<td>30,000</td>
<td>30,000</td>
<td>30,000</td>
<td>30,000</td>
</tr>
</tbody>
</table>
Key Priorities

Education

The Education sector includes the delivery of primary, secondary and tertiary education through the Departments of Education, and Higher Education, and the National Universities.

Total funding allocated to the Education sector in 2015 will be K1.9 billion (2014: K1.5 billion). The Department of Education will receive funding of K1.1 billion in furtherance of the Government's commitment to education.

The Tuition Fee-Free (TFF) policy continues to be a major priority of Government, together with training of 2,000 new teachers, a comprehensive Outcome Base Education (OBE) review and the University Infrastructure Program.

The TFF policy remains a significant cost (K605.0 million) to promote increased school enrolments at elementary and primary levels and improve learner retention rates at higher levels. In 2015, 18,232 schools in PNG will be beneficiaries of TFF education. The Government recognises the need for further resources under the TFF policy and is providing supplementary funding to the Department of Education and the Provinces for the recruitment of additional teachers, taking into account the recent large increases in teachers' awards and allowances.

Total funding of K70.0 million will also be provided for Curriculum Development Materials which includes the procurement of text and resource books for teachers in elementary and primary schools.

In addition, under the new District Education Infrastructure funding policy, each district will be provided with K3.0 million to address an accumulation of infrastructure needs within PNG schools. Understanding the need for infrastructure development in the Education sector, the Government has also appropriated funding for the rehabilitation of PNG's higher education facilities. Key priorities for the Education sector from an infrastructure perspective include the following:

<table>
<thead>
<tr>
<th>Allocation of Funding</th>
<th>(K million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>District Education Infrastructure funding policy</td>
<td>267.0</td>
</tr>
<tr>
<td>Infrastructure of seven Universities</td>
<td>62.5</td>
</tr>
<tr>
<td>Infrastructure of thirteen Technical Colleges</td>
<td>40.0</td>
</tr>
<tr>
<td>Infrastructure of eight Teachers’ Colleges</td>
<td>40.0</td>
</tr>
<tr>
<td>Infrastructure of eight Nurses’ Colleges</td>
<td>40.0</td>
</tr>
</tbody>
</table>
Law and Order

As in prior years, the Government stressed that PNG needed a robust law and justice system in order to create a strong economy.

Under the 2015 Budget, the Law and Order sector will receive funding of K1.6 billion (2014: K1.3 billion). This includes K66.0 million in donor grants to the Law and Order sector. This funding will largely be allocated to the key law and justice agencies, being Police (K367.2 million) and Defence (K261.2 million).

In addition, K15.2 million has been allocated to the recruitment of 480 recruits to Defence, 750 recruits to Police Services and 200 recruits to CIS. The increased funding to this sector has also been driven by the increased number of Judges appointed, increased court circuits held in provinces and districts and the extension of the wholly-funded village court allowances from seven officials to eleven officials per court.

Major investments in the Law and Order sector in the 2015 Budget include the following:

<table>
<thead>
<tr>
<th>Allocation of Funding</th>
<th>(K million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pacific Games Security Funding</td>
<td>30.0</td>
</tr>
<tr>
<td>PNG-Australian Law and Justice Partnership</td>
<td>55.7</td>
</tr>
<tr>
<td>Waigani Court House Complex (design and maintenance)</td>
<td>180.0</td>
</tr>
<tr>
<td>Mt Hagen Court House</td>
<td>10.0</td>
</tr>
</tbody>
</table>

Primary and Preventative Health Care

Improving access to and quality of health care in PNG remains a key enabler of achieving Government’s development goals under the Medium Term Development Plan 2011-2015 (MTDP).

In 2015 total funding for all agencies in the Health sector will be K1.8 billion (2014: K1.4 billion). The Department of Health (K614.5 million) and Hospital Management Services (K806.2 million) will be allocated the majority of the funding appropriated to this sector.

The key priorities for the Health Care sector in 2015 are to continue to subsidise free health care in 2015 (K20 million), support the creation of four new Provincial Health Authorities in West New Britain, Manus, Enga and Sandaun (K75.4 million), fund rural primary health service delivery (K25.2 million) and provide for the rehabilitation of eight Nursing Colleges (K40.0 million).

The Government has also committed to rebuilding and rehabilitating existing hospitals in 2015. A total amount of K216.0 million will be provided for the major rehabilitation of the Angau Memorial Hospital and the New Enga Provincial Hospital. An additional, K93.0 million will be distributed for capital works across the remaining provincial hospitals.
The Government also recognises the need in 2015 to assist existing Hospitals with growing operating budgets, largely increased due to raises in doctors’ and health workers’ awards. Hospital operating budgets are also being supplemented to provide additional funding for goods and services to reduce the prospect of service levels being compromised by unavailability of medical supplies and equipment. The budget for medical supplies in 2015 is K305.0 million.

Other key priorities for the Health Care sector in the 2015 Budget include the following:

<table>
<thead>
<tr>
<th>Allocation of Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>(K million)</td>
</tr>
<tr>
<td>PNG Health and HIV Procurement Program</td>
</tr>
<tr>
<td>PNG Health and HIV Financing Program</td>
</tr>
<tr>
<td>Rural Primary Health Services Delivery Project</td>
</tr>
<tr>
<td>Capacity Building Service Centre</td>
</tr>
</tbody>
</table>

**Transport**

Establishing quality national transport corridors that connect rural populations to markets and services remains a key enabler for Government under the MTDP.

In the 2015 Budget, the Government again emphasised the need to improve the three modes of transport in PNG to establish an investment platform as a basis for sustainable economic growth and effective social service delivery.

Development of the transport sector, however, has been hampered by slow government procurement processes, mismanagement of funds, landowner disputes and poor prioritization. In the 2015 Budget, however, the Government recognised that the maintenance and asset management for roads and bridges and initial emergency repairs as a result of natural phenomena was an on-going cost rather than specifically designated capital projects.

The major investments within the three modes of transport are as follows:

<table>
<thead>
<tr>
<th>Allocation of Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>(K million)</td>
</tr>
<tr>
<td>Road Networks</td>
</tr>
<tr>
<td>National Highways</td>
</tr>
<tr>
<td>Highlands Highway</td>
</tr>
<tr>
<td>City Roads</td>
</tr>
<tr>
<td>Bridges and Improve Rural Access Project</td>
</tr>
</tbody>
</table>
Utilities

It is a key enabler under the MTDP for Government to provide key utilities of electricity, clean water and sanitation and communications. Government recognises that fundamental public utilities are essential to the growth and development of all sectors of the economy.

In the 2015 Budget, the Government has allocated funding for utilities (K225.2 million) through PNG towns, the Port Moresby and Lae electrification Project (K118.0 million) and Port Moresby Sewerage (K50.6 million).

The 2015 Budget further included a number of investments aimed at the development of PNG’s telecommunications network. This stems from Government’s commitment to progress this sector, with telecommunication costs continuing to be a major impediment to business investment and economic growth. Key investments in the 2015 Budget in the telecommunications sector include development of rural telecommunication (K12.3 million) and National Broadband Network (K8.0 million).

Further under the telecommunications sector, the National Information and Communications Technology Authority (NICTA) will continue to conduct public inquiries examining impediments to access, affordability of ICT and investigating misuse for the purpose of providing appropriate recommendations for Government consideration.

Economic Sectors

Oil and Gas

The PNG economy is projected to grow sharply in 2015 by 15.5 % driven by a full calendar year of gas production.

The delivery of first gas by PNG LNG project in May 2014 was well ahead of original production time-line. The commencement of gas production is expected to contribute significantly to the growth in the Oil and Gas sector; the sector is expected grow at 156% in 2015 due to the first full calendar year of gas production. While peak production has been delayed to 2016, gas production is expected to be well over ¾ of capacity providing a substantial boost to the sector and also the economy in general.
The oil and gas sector is expected to return to negative growth over the medium term depicting the continued natural decline of the oil fields. This is expected to set in around 2017 after peak LNG production is absorbed in 2016.

The continued depressed global economic conditions which have led to a decrease in commodity prices could result in lower than expected growth in this sector and lower export receipts. This would directly affect the Government’s revenue and domestic economic growth and is specifically cited as a risk for the 2015 Budget projections.

**Mining**

The mining and quarrying sector is expected to grow significantly at 12% in 2015. This growth is driven by better implementation of strategic mining plans over the past year with better calibration of production targets.

The past two years have seen this sector plagued with rising input costs and a weakening Kina, which difficulties are projected to continue to subside in 2015.

Government has also provided positive assistance through improved security at certain designated mines. This has seen a reduction in disruptions and assisted these mines to meet production targets in 2014 and is expected to again assist in 2015.

The 2015 Budget provided no specific expenditure plan for the mining sector in 2015.

**Agriculture**

Total non-mining GDP is expected to grow at 4% in 2015, recovering from the slower 1.4% in 2014. The rebound in the non-mining sector in 2015 is expected to be driven by recovering construction, agriculture, forestry and fisheries sectors. The agriculture sector is projected to expand by 3.6% in 2015. This is due to the improvements expected in the growing environment for coffee and cocoa supported by copra oil production.

In 2015, the Government will provide K730.0 million to support the growth of the Economic and Agricultural sector in PNG. Of this funding K141.3 million will be targeted at developing the potential of agriculture and small to medium enterprises.

The Department of Agriculture and Livestock as the agency responsible for the sector has developed the National Agriculture Development Plan 2007-2016 to guide policy development and implementation in this sector. The Government will provide over K180.0 million for projects of national significance to this sector. The Government’s major investments in this sector are K50.0 million for National Development Bank and Small to Medium Enterprise, K50.0 million for basic infrastructure in agricultural corridors and K50.0 million for the Agriculture Commercialisation Equity Fund, the aim of which is to attract investors in the coffee, cocoa, oil palm, rubber and livestock industries.
Through these initiatives, the Government aims to increase the export of the following agricultural commodities:

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Est.</td>
<td>Proj</td>
<td>Proj</td>
<td>Proj</td>
<td>Proj</td>
</tr>
<tr>
<td>Copra</td>
<td>13.2</td>
<td>39.1</td>
<td>33.5</td>
<td>30.6</td>
<td>29.8</td>
<td>33.4</td>
</tr>
<tr>
<td>Copra Oil</td>
<td>24.5</td>
<td>15.3</td>
<td>38.0</td>
<td>31.1</td>
<td>29.4</td>
<td>30.3</td>
</tr>
<tr>
<td>Cocoa</td>
<td>206.0</td>
<td>304.8</td>
<td>335.8</td>
<td>341.2</td>
<td>313.3</td>
<td>350.7</td>
</tr>
<tr>
<td>Coffee</td>
<td>336.6</td>
<td>488.2</td>
<td>593.1</td>
<td>667.3</td>
<td>688.7</td>
<td>708.1</td>
</tr>
<tr>
<td>Palm Oil</td>
<td>903.5</td>
<td>884.2</td>
<td>1062.2</td>
<td>1169.9</td>
<td>1156.7</td>
<td>1111.8</td>
</tr>
<tr>
<td>Rubber</td>
<td>19.4</td>
<td>17.4</td>
<td>21.2</td>
<td>16.3</td>
<td>15.7</td>
<td>15.2</td>
</tr>
<tr>
<td>Tea</td>
<td>10.4</td>
<td>1.5</td>
<td>12.1</td>
<td>11.6</td>
<td>11.6</td>
<td>11.6</td>
</tr>
</tbody>
</table>

**Fisheries**

PNG has the largest fisheries zone in the South Pacific with an Exclusive Economic Zone of 2.4 million square kilometres.

In recognising the significant potential of this sector the Government endorsed the National Fisheries Development Plan Framework (NFDPF) 2006-2016. Key priorities under the NFDPF include increasing the value and volume of downstream products, promoting quality fish products, encouraging sustainable fishing, improving fishing communities’ access to markets and encouraging vertical and horizontal linkages between markets.

Key investments for the Fisheries industry in the 2015 Budget include the following:

<table>
<thead>
<tr>
<th>Allocation of Funding</th>
<th>(K million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pacific Marine Industrial Zone</td>
<td>33.8</td>
</tr>
<tr>
<td>Wharves and Jetties Rehabilitation (K2.5m for 15 maritime districts)</td>
<td>20.0</td>
</tr>
<tr>
<td>Fisheries Surveillance</td>
<td>10.0</td>
</tr>
<tr>
<td>Wagan Wharf Development</td>
<td>10.0</td>
</tr>
</tbody>
</table>
Forestry

The Government continues to expect production to increase in the Forestry sector in 2015 following depressed levels of activity over past years. The medium term prospects for the Forestry sector continue to remain uncertain due to data limitations.

A significant issue in the forestry sector remains land availability for plantations. The Government aims to further increase production through initiatives like the Productive Partnership in Agriculture (PPAP), an objective of which will include the rehabilitation of existing plantations.

Tourism

Tourism in PNG has great potential given the abundance of natural environment and resources that could contribute significantly to PNG’s economy if appropriately and sustainably developed.

In the 2015 Budget, the Government has allocated K20 million for Tourism development. In addition to this, Government has allocated K10.2 million to the Kokoda Track Initiative. This represents a significant increase in the appropriation of funds to the Tourism industry from prior years. This is in line with the Government’s aim to focus on the Tourism and Agricultural industries to generate income earning opportunities for Papua New Guineans living in rural areas.

Manufacturing

The manufacturing sector in PNG is dominated by industries processing natural resources (agricultural and non-renewables) to finished products such as canned fish, furniture, biofuel, refined palm oil, canned meat, plywood and veneer. PNG’s manufacturing is highly concentrated in Port Moresby and Lae and to a lesser extent Madang with these three centres containing about 70% of the manufacturing sector.

Sectors such as manufacturing, wholesale and retail trade continued to grow in 2014 and are expected to do the same in 2015. Employment within the Manufacturing sector grew in 2014 by 1.4%. The higher growth within this sector in prior years reflected a moderation in domestic demand due to the slowdown of the PNG LNG project construction activities and lower commodity prices. This sector is expected to revert back to trend growth in the medium term.

The Government aims to transform the sector from a predominantly light manufacturing to higher value production as well as adapting new technologies. Strategies to achieve this goal consistent with the MTDP include promoting export orientation, promoting the tuna processing industry in PNG, attracting foreign investment in PNG, removing inefficiencies and other measure to lower the cost of doing in business in PNG.
Overview

This year there were no significant changes in terms of tax rates or the composition of the tax base. That outcome is not unexpected, given the ongoing research and consultation being undertaken by the Tax Review Committee. That Committee has now had its final reporting date, for recommendations to Government, extended until 31 July 2015.

In terms of income tax changes the items of note are:

- Definitions of the terms debt, equity and interest as inserted in 2013 are now restricted in application to just the thin capitalisation regime.
- Expansion of the 150% deduction re 2015 Pacific Games donations to include sponsorships as well as gifts.
- Making prescribed royalty payments subject to a final 5% withholding tax.
- Introducing prison time penalties for tax avoiders who do not comply with court orders as to payment of liabilities.

Other tax changes worthy of mention are:

- Introducing a company director penalty regime for unpaid GST amounts, to match that already in place for unpaid salary or wages tax amounts.
- A new stamp duty compliance measure requiring landlords to include their IRC issued TIN number on all property leases submitted for stamping.

Customs and excise changes that have been made include:

- Automatic indexation of the excise on tobacco products by a flat 5% every six months
- Introduction of new excise tariff item codes for certain meat and edible offal products plus for cigarette types not previously classified.

Income Tax

Thin Capitalisation

A new thin capitalisation regime, applicable to companies other than resource companies, was introduced in 2013. Accompanying that introduction, new or expanded definitions of the terms “debt”, “equity” and “interest” were inserted into the Income Tax Act (the Act), amongst the general definitions at section 4. As a result these definitions had application right across the Act. This has raised the possibility of certain transactions being characterised as both interest and as a dividend. To remove such uncertainties these definitions are now removed from section 4 and
reinserted at section 68AF, so they only apply to the thin capitalisation regime. These measures are effective retrospectively to 1 January 2013.

150% Deduction for Donations to the 2015 Pacific Games

Since 2012 taxpayers have been able to claim a 150% tax deduction for “gifts” of money or property in excess of K500,000 to various official bodies in charge of these games. The availability of this deduction expires after 31 December 2015. To increase the practical worth of this deliberate concession, the provisions at section 69K of the Act have been extended to allow this deduction also for assistance by way of sponsorship. They have also been amended to direct the Internal Revenue Commission (IRC) to fairly value the worth of such property and sponsorship donations.

Prescribed Royalties Final Withholding Tax

The classification of “prescribed royalties” covers payments received by customary landowners in recompense for the exploration, extraction, processing or transport of minerals, oil and gas, fish or timber resources located on their land. Previously these payments came within the business payments tax regime. As such they were subject to a deduction of 5% withholding tax by the payer at source, but then in principle subject to being included in an annual tax return, with credit allowed for the withholding tax. To remove the practical inefficiencies this caused, these types of royalties are now removed from that regime, and specifically subject to 5% withholding as a final tax. These measures are effective as of 1 January 2015.

It should be noted that the traditional treatment of other royalty payments, involving intangible assets such as naming rights, copyright or licensing agreements, is unaffected by this change.

Prison Time Penalties Introduced

Section 315 of the Act makes provision for penalties in the case where a taxpayer fails to comply with a court order consequent to certain tax liability defaults. Such penalties have previously been limited to monetary fines, but have now been extended to include prison terms of up to 12 months for individuals, including public officers of companies. At the same time, the range of monetary fines has been increased, for individuals to between K1,000 and K10,000 and for companies to between K5,000 and K50,000. These measures are also effective as of 1st January 2015.

Other Income Tax Technical Amendments

- The secrecy provisions of the Act are amended to allow the IRC to communicate aggregated information to the Treasury and the National Statistics Office, for revenue and other analysis purposes, provided it does not identify taxpayers specifically. The amendments as drafted also allow information identifying taxpayers to be passed to Treasury or the Minister when considering or reporting on specific tax incentives.

- The director penalty regime already in place for unpaid salary or wages tax is further amended to prevent any remission of penalty in certain cases where directors wind up the company in an effort to escape reporting requirements.
Stamp Duty

Stamp duty legislation provides that a document may not be relied upon in a court of law unless it has been stamped. The Stamp Duties Act is amended such that for any real property lease to be stamped, it must contain the IRC issued TIN (tax identification number) of the owner of the property in question. The IRC will then use this detail to match against income declared in tax returns or to identify non-lodgers, thus markedly reducing tax avoidance opportunities for those in receipt of rental income. According to the draft bill for this measure, it takes effect from 1st January 2015.

Goods & Services Tax

Directors’ Penalty Regime

Similar to the existing penalty regime for unpaid salary or wages tax that applies to directors of companies, a new division will be included in the Goods and Services Tax Act to penalise company directors in certain cases of unpaid GST amounts. This will bring their liability into line with that which has applied to sole traders and partners in partnerships who are already liable for unpaid GST in similar circumstances. This addition also takes effect from 1st January 2015.

IRC Distribution of GST Revenue

The primary protocols dealing with IRC’s administration of the National GST Trust Account and distributions to the Provincial Governments’ GST Trust Accounts, have been contained since 2009 within the Inter-Governmental Relations (functions and Funding) Act. However, conflicting distribution mechanics in at least one other national Act have caused the IRC some problems. The law is now changed to ensure the 2009 primary protocols prevail, effective from 1st January 2015.

Customs & Excise

Tobacco Products Automatic Indexation

The excise rate applicable to most tobacco products is traditionally indexed as of the 1st June and again on the 1st December each year. This indexation has previously been capped at the lower of CPI increase or 2.5%. Recognising the health impacts and health system costs that smoking causes, the Government has amended the Excise Tariff Act to increase that indexation level to a flat 5% from now on. This means the excise rate applicable to normal filter cigarettes from the 1st December 2014 will be K261.51 per 1000 sticks.

New Tariff Products

For certain types of cigarettes containing unique tobacco compositions there were no appropriate descriptions in the Customs Tariff Act. New ones have accordingly been added, suffering duty at the rate of K65 per 100 sticks.

There was previously confusion as to the duty rate applicable to the category of products, especially poultry products, described as ‘other meats and edible offal’ which do not fall within the separate category of ‘mechanically deboned meat’. To resolve this, another new item is added to Schedule 1 of the Customs Tariff Act for such products and suffers duty at K1.80 per kilogram.
Non-Tax Fees and Charges

In keeping with ongoing work by the Tax Review Committee, to review the overall policy framework for non-tax revenues, the Government has decided to increase and update fees and charges levied by certain government agencies from 1st January 2015. Affected agencies are the Department of Health, Police, Lands and Physical Planning, Labour and Industrial Relations plus Community Welfare and Development.

Fees charged by other government agencies are expected to be updated from 2016 onwards, to better reflect the cost of service delivery.

Other Deloitte Contacts

**Helen Hamilton-James**
Office Managing Partner  
Tel: +675 308 7135  
hamiltonjames@deloitte.com.au

**Zanie Theron**  
Partner – Assurance & Advisory Services  
Tel: +675 308 7028  
ztheron@deloitte.com.pg

**Ben Lee**  
Partner – Assurance & Advisory Services  
Tel: +675 308 7128  
benlee@deloitte.com.pg

**James Kruse**  
Partner – Professional Business Services  
Tel: +675 308 7060  
jkruise@deloitte.com.pg

**Kirsty Laird**  
Partner – Risk and Consulting Services  
Tel: +675 308 7119  
klaird@deloitte.com.pg
General Information Only
This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the “Deloitte Network”) is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte’s approximately 200,000 professionals are committed to becoming the standard of excellence.

About Deloitte Papua New Guinea
Deloitte in Papua New Guinea is represented by the Papua New Guinean partnership of Deloitte Touche Tohmatsu (which is controlled by the Australian partnership of Deloitte Touche Tohmatsu, the DTTL member firm in Australia). Deloitte is one of Papua New Guinea’s leading professional services firms, providing audit, tax, consulting, and financial advisory services through approximately 150 locally based professionals. With deep knowledge of the diverse local market combined with international expertise, we are dedicated to helping our clients and our people excel. For more information, please visit Deloitte’s web site at www.deloitte.com.pg.

Member of Deloitte Touche Tohmatsu Limited

© 2014 Deloitte Touche Tohmatsu