THE 2001 NATIONAL BUDGET

The National Budget is the single most important fiscal tool available that the Government uses as a yardstick to raise and allocate funds and measure its performance in a fiscal year. At the macroeconomic level, the budget is very important because of its impact on aggregate demand in the economy.

This article reviews the 2001 National Budget, presented in November 2000, with its primary focus on the macroeconomic aspects, its likely impact on the economy and the proposed changes to the components of the revenue and expenditure. As with previous budget articles the detailed budget data has been rearranged and aggregated. Some misclassification of data may occur as a result of this process but the primary focus here is the broad aggregates and trends.

The fiscal strategy of the 2001 Budget aims to continue the trend towards a balanced budget, similar to the 1999 Supplementary Budget and the 2000 National Budget. A budget with no allowance for general financing from borrowing is seen as the appropriate strategy towards restoring stability and integrity to the economy and banking system. Although the deficit levels still exist in the 2001 Budget framework, the reduction of deficit by half a percentage point, as a proportion of GDP, represents a significant improvement. To achieve the objective of a balanced budget the Government has to allocate the limited revenue raised internally and the grants from traditional development partners with due care. As a result the Government has identified health, education, law and order, agriculture and livestock, transport and works, civil aviation and revenue raising as its priority areas. These departments are the only ones eligible for additional funding in 2001.

The Budget has also taken into account the Government's Structural Reform Program (SRP) for 2001, which comprises of comprehensive measures in areas of public and financial sector reform and privatisation. These reforms aim to achieve macroeconomic stability and promote long term economic growth, improve public sector performance, remove barriers to investment and economic development, and promote good governance.

The International Monetary Fund (IMF) and World Bank have endorsed the 2001 Fiscal Strategy and SRP, which has provided the confidence needed for budget support loans. As a result in the 2001 fiscal framework, the assumption is that substantial budget support loans of K424.2 (US$140) million will be available from the "Friends of Papua New Guinea" and International Financial Institutions. The balance of payment support will continue to come from the IMF under the 14-month Stand-by Arrangement, which ends in mid-2001.

The Budget was formulated in light of expected economic developments in 2001. Real GDP is projected to increase by 3.1 percent in 2001, compared to 0.8 percent in 2000. The main contribution to increased growth is expected to come from the agriculture/ forestry/fisheries and construction sectors. The estimated growth of 10.1 percent in the construction sector reflects the commencement of construction of the Ramu/Nickel and the PNG to Queensland gas pipeline projects.

Table 1, summarises the fiscal developments from 1997 to 2000 and provides the Budget indicators for 2001. The 2000 projected appropriation outcome is higher than the budgeted appropriation and represented an increase of K119 million, compared to the 1999 outcome. This reflected increases in National Government recurrent expenditure, development expenditure and higher interest payments. The fiscal burden on the economy, as represented by the appropriations/GDP ratio, increased in 2000, compared to 1999 despite of a lower deficit in the 2000 preliminary outturn, compared to the 2000 budgeted deficit. The increase in Government expenditure was more than offset by the nominal private sector GDP growth resulting in an appropriation/GDP ratio of 28.9 percent, compared to a corresponding ratio in 1999 of 30.8 percent. As a result of the adopted policy to increase development expenditure, the appropriations/GDP ratio is expected to increase to 30.8 percent during 2001, similar to 1999.

The overall size of the 2001 Budget, at 30.8 percent of GDP, is large but typical of many developing countries where the Government has extensive direct and indirect involvement in both economic and social development. In the absence of a measure of the efficiency of Government expenditure, it is not possible to estimate precisely the impact Government size has on economic growth.

The 2000 preliminary fiscal out-turn showed a deficit of 1.7 percent of GDP, which is above the 2000 National

Table 1: Budgetary Indicators
(K'million)

	1997	1998	1999	2000 Original Budget	2000 (p)	2001 Budget
1. Total Internal Revenue & Grants	2202	2348	2569	2867	3009	3223
2. Surplus/(Deficit)	15	-137	-232	-215	-192	-141
3. Appropriations = 1 - 2	2186	2486	2801	3082	3201	3364
Memorandum Items:						
4. Borrowed Funds	402	341	766	620	754	559
5. GDP (Current Prices)	7064 r	7863 r	9103	11468	11066	10931
(Ratios to Current Price GDP in %)						
6. Appropriations/GDP	30.9 r	31.6 r	30.8	26.9	28.9	30.8
7. Total Internal Revenue/GDP	31.2 r	29.9 r	28.2	25.0	27.2	29.5
8. Surplus or Deficit/GDP	0.2	-1.7 r	-2.6	-1.9	-1.7	-1.3
9. Borrowed Funds/GDP	5.7 r	4.3 r	8.4	5.4	6.8	5.1
(Growth rates in %, year on year)						
10. Appropriations	17.5	13.7 r	4.0	10.0	3.9	5.1
11. GDP (current prices)	2.2 r	11.3 r	7.0	26.0	-3.5	-1.3
12. Headline Inflation (average year on year)	5.3	13.6 r	14.9	12.9	15.6	11.6

Source: Bank of Papua New Guinea.
2001 Budget Papers, Volumes 1, Department of Treasury and Planning.

Budget projection of 1.9 percent deficit, despite a lower level of GDP growth. Total revenue was K3,009 million, K142 million above the Budget, while total expenditure was K3,201 million, resulting in a reduced deficit of K192 million. The Budget deficit was financed through a net external draw down of K70 million and a net domestic financing of K122 million. The net external financing comprised of an extraordinary draw down of K270 (US$70.7) million, which more than offset repayments of K128 million to concessionary sources and K72 million to commercial sources. Amongst the draw down was K72 million from the Japanese Bank of International Cooperation, K31 million from the Australian Government, K84 million from the World Bank, while the remaining K83 million was from other sources. The domestic borrowing requirement of K122 million was financed through net draw downs of K256 million from the commercial banks, K158 million from the non-banking system and K70 million from other domestic sources. These more than offset a net repayment of K362 million to the Bank of Papua New Guinea.

The headline Budget deficit for 2001 is projected at K141 million. Net concessionary and commercial repayments are budgeted at K114 million and K79 million respectively, while external extraordinary financing is projected at K424 million. This results in a domestic repayment of K90 million, which represents a significant reduction in domestic debt. These budgeted financing assumes that K178 million to be raised from the privatisation program will be used to retire domestic debt.

The 2001 Budget is less expansionary and aims to limit dependence on the domestic financial system by increasing draw downs from external sources. This development is encouraging, as a successful implementation of the 2001 Budget will reduce pressure on the domestic banking system and increase the effectiveness of monetary policy.

Table 2: Distribution between Revenue and Financing items in the 2001 Budget (K' million)

	1997	1998	1999	2000 Original Budget	2000 (p)	2001 Budget
1. Total Internal Revenue & Grants	2202	2348	2569	2867	3009	3223
2. Direct Taxes	1009	1008	1198	1269	1470	1520
3. Indirect Taxes	671	590	723	810	845	956
4. Department Rev. & Services	152	182	86	154	123	105
5. Revenue from Assets	59	97	86	91	64	92
6. Grants	311	470	477	542	507	551
Memorandum Item:						
7. Borrowing	402	341	766	620	754	559
(Ratios(%))						
8. Direct Taxes/Total Revenue	45.8	42.9	46.6	44.3	48.8	47.2
9. Indirect Taxes/Total Revenue	30.5	25.2	28.1	28.3	28.1	29.7
10. Dept. Revenue/Total Revenue	6.9	7.8	3.3	5.4	4.1	3.3
11. Revenue from Assets/Total Revenue	2.7	4.1	3.3	3.2	2.1	2.9
12. Grants/Total Revenue	14.1	20.0	18.6	18.9	16.8	17.1
Memorandum Item:						
13. Borrowings/Total Revenue	18.3	14.5	29.8	21.6	25.1	17.3

Source: Table 1

Table 2, which presents the distribution between revenue items, shows that the total revenue for 2000 represents an increase of 17.1 percent, compared to 1999. This reflects higher personal and company tax as well as MRSF tax receipts, dividend withholding, gaming, and export tax and mining levy.

In the 2001 National Budget, no new tax measures were introduced, however, improvements and simplifications were made to existing taxes in order to improve compliance and collection as recommended by the Taxation Review Committee. Therefore assumptions of increases in both direct and indirect taxes in 2001 are based on a pick up in economic activity and higher efficiency in tax collection.

Total budgeted revenue for 2001 is 7.1 percent higher, compared to 2000. Direct taxes are projected to increase by 3.4 percent and account for 47.2 percent of total revenue. MRSF tax collections are expected to increase to K317 million in 2001, from K280 million in 2000, due to the improved outlook for gold, oil and copper prices. Other reasons for the increase in direct taxes in 2001 are: the improvement in economic activity, greater efforts in collection of tax arrears and higher wages and salaries resulting from a 12 percent salary increase within just two years.

Indirect taxes are expected to increase by 13.1 percent in 2001 and account for 29.7 percent of total revenue. Non-tax revenue and grants are expected to rise due to increased dividend payments from mining companies and statutory bodies, including the Bank of Papua New Guinea, as well as arrears collections.

Table 3 provides a breakdown of total expenditure into National and Provincial Government recurrent and development expenditure. The share of current expenditure over total appropriation increased in 2000 reflecting an increase in the salary and wages bill to accommodate the salary adjustment. The share of development expenditure in total appropriation for 2000 represents 26.5 percent of total appropriations, compared to 26.3 percent in 1999, and represents 84.5 percent of the budgeted total.

The 2001 Budget estimate indicates that total expenditure will be 5.1 percent above the preliminary 2000 outturn. Recurrent national level expenditure is expected to be 3.4 percent lower, development expenditure is expected to be 23.8 percent higher, and recurrent Provincial Government spending is expected to be 3.7 percent higher.

The percentage share of recurrent national level expenditure to total appropriations is expected to decrease to 51.4 percent in 2001, from 55.9 percent in 2000. The percentage share of development expenditure to total appropriation for 2001, including AusAID grants and the one-off Structural Adjustment Programme (SAP) expenditure, is expected to increase to 31.2 percent, from 26.5 percent in 2000. These developments are consistent with the policy to increase development expenditure as a percentage of total appropriations and reduce recurrent expenditure.

The 2001 Budget revenue, expenditure and financing measures will impact on the exchange rate, inflation and monetary control. With a floating exchange rate, if there are excessive injections of liquidity into the monetary system, the exchange rate will decline, resulting in a rise in the price of imported goods and domestic inflation. The major threat to the exchange rate, inflation and monetary control, remains the vast

Table 3: Appropriation Between Sectors
(K' million)

	1997	1998	1999	2000 Original Budget	2000 (p)	2001 Budget
1. Total Appropriation	2186	2486	2802	3082	3201	3364
2. Current Expend. National Level (a)	1235	1329	1472	1560	1788	1728
3. Development Expenditure (b)	373	535	736	1004	849	1051
4. Provincial Government (c)	578	622	594	517	564	585
Ratios (%)						
5. Current Expenditure/Total Appropriation	56.5	53.5	52.5	50.6	55.9	51.4
6. Dev. Expenditure/Total Appropriation	17.1	21.5	26.3	32.6	26.5	31.2
7. Provincial Govts/Total Appropriation	26.4	25.0	21.2	16.8	17.6	17.4

Source: Bank of Papua New Guinea.
2001 Budget Papers, Volumes 1 & 2, Department of Finance & Treasury.

(a) Current Expenditure, National Level includes interest payments and transfers to CSAs.

(b) Development expenditure includes Australian project grants

(c) Provincial Govt's is recurrent expenditure only.

build up of liquidity generated by unsustainable levels of domestic financing.

Whatever theory underpins a Budget, the overall fiscal policy that a country pursues must, in addition to being internally consistent and compatible with the broader objectives of the Government, be sustainable. If the Budget deficit and a sustainable level of domestic financing are to be achieved in 2001, the Government must refrain from excessive expenditure over-runs, which can exert excessive pressure on the domestic financial system and the foreign exchange market. Moreover, if Government revenue or external financing targets fall short of expectations, expenditure levels should be reviewed and cut, rather than reliance on domestic financing to meet budgeted expenditure levels. Any increase in domestic financing to cover revenue or financing shortfalls will further compound the current economic fragility and difficulties, and will delay the resumption of stability and growth of the Papua New Guinea economy. In this context, it is important that the current structural reforms already undertaken by the Government is successfully implemented and that expenditure in priority areas are adequately funded, in order to achieve long term sustainable growth. The succession of economic crises in Papua New Guinea testify to the need for broad-based economic and social development, which requires the fundamentals, as identified by the Medium Term Development Strategy and the SAP, to be corrected and firmly put in place.