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Papua New Guinea National Budget 2022

A review of the Budget's major business implications

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Contents

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Executive summary

The 2022 Budget has support for economic growth as its top priority and sets the stage for fiscal consolidation over the medium term. This Budget is once again a high deficit budget.

The K5.985bn deficit projected for 2022 is an improvement from the 2021 Budget and brings the deficit to GDP ratio to just under 6%. This challenging deficit budget is comprised of revenue of K16.19bn and expenditure of K22.175bn. This will increase the level of public debt (excluding valuation changes and outstanding arrears) to K52.765bn which is 51.9% of GDP. On a percentage basis, the planned revenue growth exceeds the expenditure increase by around 10% and is on the backdrop of an improving global market and commodity prices as the world emerges from the economic contraction induced by the COVID-19 pandemic.

On the revenue side, the K16.190bn budgeted is funded through mainly local tax collections of K12.522bn and international donor aid of K1.824bn. It is noted that international donors have increased governance and fiscal requirements to provide facilities, such as SOE reforms. On the tax collection front, a point to note is the expected lag in revenue which is highly dependent on the timing of the startup of resource projects.

On the expenditure side, total expenditure rises from K19.608bn to K22.175bn. Health, education, and law and justice are the focus areas as in the past, with the increases attributable to the 2022 general election and government arrears funding requirements. The payment of outstanding government accounts is vital to get the private sector up and running and availability of forex will continue to be important. The current estimated stock of government arrears is around K5. 2bn.The Arrears Verification Committee has made some positive progress in clearing long outstanding local business debt, which will serve to restore some trust in government and improve its ability to source goods and services.

During the previous Budget it was noted that the public services wages bill, which is significant, continues to increase year on year. It is evident that a fundamental decision at the institutional level will have to be made in the coming years. The government has implemented a public service retirement exercise aimed at reducing and downsizing its workforce. This is expected to improve the public services wage bill in the long term.

The 2022 Budget introduces a market concentration levy on commercial banks (K190m) and telecommunications companies (K95m) with more than a 40% market share. This measure will only apply to one of the four commercial banks, which incidentally is the PNG owned bank, and to one telco. It is the government's view that a dominant player in the market is able to collect "super-normal profits" and therefore the market concentration levy is a claw back of those "super-normal profits". Feedback from the market is that these two unexpected taxes with minimal prior consultation target specific large corporations, and the general view is this will be challenged vociferously. Changes of this nature may have other unintended consequences, including deterring foreign investors.

The alcohol and tobacco industries have expressed serious concerns on the negative effect of higher excise rates coupled with the effect of COVID-19. As a reprieve, the Budget provides direct assistance to these sectors by reducing the bi-annual excise indexation rate from 5% to 2.5%. The new re-written Income Tax Act is now expected in 2023. As in previous recent Budgets there has been another reprieve from the introduction of capital gains tax.

As in the past, with a deficit of this size, stakeholders and businesses need to understand how the deficit will be funded. K3.745bn (c. 63%) is expected to be funded through external debt, with debt funding of K1.333bn already secured, and the remaining 37% to be funded internally by issuing Government Securities and Bonds. The resultant 51.9% debt to GDP ratio is a slight improvement from the previous year. The target has been set to return the debt ratios to below 45% by no later than 2027.

Generally, the government is very optimistic about an expected 4.6% real growth in GDP. This hinges on a rebound in economic activity in both the mining and non-mining sector as the global economy emerges from the COVID-19 pandemic. Year on year growth over the last couple of years has the PNG economy becoming a K100bn economy by the end of 2022.

Key insights from the 2022 Budget

A summary of key elements of the 2022 budget.

Economic Analysis

- A strong recovery from resumption of mining operations at Porgera.
- Inflation rising on the back of imported inflation
- Many of the commodities and minerals produced by PNG experienced strong prices on the back of increasing economic activity and recoveries from the COVID-19 pandemic induced demand shock.

Economic Assumptions

- Strong growth of 5.4% real growth is expected in 2022 after 1.5% in 2021, due to mining sector recovery of 35.8% with the planned Porgera mine resumption
- In 2021 higher export commodity prices and higher GoPNG external borrowing have increased inflows of FX.
- 2021 inflation of 5.0% is expected to rise further in 2022 to 5.6^

Fiscal Strategy & Budget Financing

- A budget deficit in 2021 of 50.1 percent of GDP is expected to worsen in 2022 and 2023, before declining to a balanced budget in 2027.
- The gap between the proposed financing instruments and the deficit is concerning.
- GoPNG has taken advantage of the concessional loans in terms of availability and cost and looks to continue this strategy - the domestic market has provided valuable liquidity but is more expensive.

Revenue

- The year-to-date collection data for CIT and GST indicates that the 2021 Supplementary Budget may not be achieved.
- Due to the COVID-19 restrictions there have been fewer inspections and compliance activities undertaken by the IRC impacting 2021 revenues.
- We note that the vaccination rate in PNG remains low (below 5%) maintaining international travel restrictions for PNG.

Expenditure

- Expenditure overall grew by 13.1% to K22.2bn and will need to be financed by a K6bn budget deficit.
- Operational spending is forecast to grow by 10.6% and capital spending by 17.1%.
- Sectoral allocations appear reasonable with a strong focus on developing a sustainable economic base.

Taxation

- The two dominant bank and telecommunication companies are badly hit in this Budget due to the new Market Concentration Levy.
- The new levy of K190m (bank) and K95m (telco) is likely to impact investor confidence and sentiment in PNG, consumers and superannuation members.
- The tobacco and alcohol industries and refined petroleum importers are the real winners from this Budget.

"This Budget continues the primary themes from last year's Budget, namely spend the money more wisely, raise revenues more fairly and finance debt more cheaply"

Economic analysis

In the 2022 Budget, GoPNG has set out a 13-year plan to provide the 'fiscal spine' for the economic growth strategy. It works towards delivering on inclusive sustainable growth outcomes, predicated on support to the non-resource sector to broaden growth.

The fiscal position of GoPNG was always difficult, prior to the COVID-19 pandemic, but the pandemic has made the outlook more difficult. The past period has been characterised by strong commodity prices, benefitting PNG, but the demands of the COVID-19 environment and the disruptions to economic activity have made the Treasurer's job more difficult. Multi-lateral funding support has cushioned the impact to a degree and GoPNG has worked hard to retain its economic footing. The deficit is high, but lower than last year, and it is being financed but there is a lack of fiscal firepower to implement meaningful reform.

Accordingly, GoPNG has shifted the focus to the longer term, with projections of a return to a balanced budget in 2027 on the back of inclusive growth and development. Key to the 2022 GDP growth projection is the restarting of Porgera Mine and this may provide the impetus needed to get a deal done and ensure that PNG takes advantage of its resource opportunities. A reopening is likely to be met by a weaker commodity price than recent years as global inflationary pressures build and force a focus on the potential rise in rates, which reduces the attraction of gold as an asset class. High energy prices will continue to underpin export revenues.

The theme of the 2022 Budget is "lighten the burden" based on the doctrine that empowered and able citizens will take ownership and participate in nation building and contribute to social and economic advancement.

To this end the Budget discusses economic stimulus for growth underpinned by enabling legislation. Fairer tax regimes is expected to lighten the load on businesses and individuals. Availability of credit and appropriate financial products, particularly for MSMEs is targeted to boost small business. As with last year, the focus is on budget repair and reconstruction.

Key Insights

- A strong recovery is expected off the back of the resumption of mining operations at Porgera. Without this 2022 will be hard to achieve.
- Inflation is rising on the back of imported inflation and expected government spending in 2022 with elections scheduled.
- Many of the commodities and minerals produced by PNG have experienced strong prices on the back of increasing economic activity and recoveries from the COVID-19 pandemic induced demand shock. This has been supportive of the economic backdrop.

Economic assumptions

The Budget estimates are based on a range of assumptions including revenue collections, economic growth and commodity prices. Volatility in economic fundamentals presents significant risks for a comparatively narrowly based economy like PNG. Key assumptions underpinning the Budget are presented below.

Key Economic assumptions	Comment	2021 ave	2022
Total Real GDP Growth	In 2021 the domestic economy is projected to grow by 1.5%, down from the MYEFO estimate of 1.8% largely due to COVID-19 pandemic impacts. Looking forward strong growth of 5.4% real growth is expected in 2022. Mining sector growth of 35.8% due to Porgera mine resumption after a 12.5% contraction in 2021. Non-resource sector is expected to grow 3.5% with recovery and election spending. Overall growth is anticipated to be more broad-based.	1.5%	5.4%
Non-mining Real GDP Growth	Growth of 3.5% is expected in 2022 after 3.9% in 2021. With a recovery in the agriculture, fishing and forestry sector (3.9%) where growth has been driven by increased labour mobility, higher commodity prices and price support and freight subsidies. The business liaison sector has struggled with higher operational costs, law and order issues, higher shipping costs and adverse conditions from the COVID-19 pandemic. Sectoral performance has been mixed.	3.9%	3.5%
Real exchange rate index	In 2021 higher export commodity prices and higher GoPNG external borrowing have increased inflow of FX. The Kina continues to depreciate against the US$. Against the AUD the Kina appreciated due to cross currency movements with AUD weakening against USD. The Real effective index shows a small decline indicating less competitive exports.		
Monetary Policy & Kina Facility Rate	Monetary policy continues to be accommodating with the Kina Facility Rate maintained at 3.0% since Mar20. In H121 money supply increased 9% and is expected to be 9.8% in 2021 driven by central government net claims (12.8%, being the issue of securities to finance the 2021 budget) and private sector lending (3.0%). This offset the decline in net foreign assets of 5.6%.	3.0	3.0
Inflation avg on avg	Projected to be 5.0% for 2021 pushed by imported inflation and higher energy and shipping costs. This is expected to rise further in 2022 to 5.6% with election spending and economic recovery adding to the factors which pushed up prices in 2021.	5.0%	5.6%

Key Economic assumptions	Comment	2021 ave	2022
Balance of Payments & International Reserves	A positive trade balance, reflecting higher export commodity prices in H121, resulted in a current account surplus of K9.6bn. The income account had a deficit of K1.7bn for H121 with higher income and dividend payments to non-residents with greater availability of FX. In 2022 the current account surplus is expected to rise 12% to K22.7bn with higher mineral production, higher export prices and higher agricultural exports.		K22.7bn
Oil (US$/barrel)	Oil prices increased sharply in Q3 2021 as demand rises off the back of economic activity. COVID-19 pandemic conditions created subdued demand for much of 2020 and the Delta wave had an impact too. Prices are expected to moderate into 2022 as production increases and weather-related demand slows.	66.1	63.9
LNG (US$/MMBtu)	PNG LNG was 41.8% of exports in 2021 and is expected to be 37% in 2022. 75% of sales are on long term contracts linked to the crude oil price. LNG prices in 2021YTD have risen sharply from a low of $5.9 in Oct202 to $12.4 in Oct2021. Prices are expected to continue to rise with supply side disruptions, rising demand and weather events in the short term with longer term stabilisation.	10.3	9.6
Gold (US$/oz)	Prices have been relatively strong during 2021 on rising safe haven demand and low interest rates. However, the inflationary pressures in developed economies are driving up rate rise expectations.	1,795	1,788
Copper (US$/tonne)	Copper prices performed well in 2021 rising to an all-time high of US$10,720 with electric vehicle demand underpinning anticipated copper demand. The fundamentals of demand are anticipated to continue with rises in production moderating prices.	9,117	9,058
Copra (US$/tonne)	Copra oil prices are expected to rise in 2022 from current levels as demand likely to pick up from expected recovery in global economic activity and limited supply conditions.	1,470	1,470
Cocoa (US$/tonne)	Prices broadly stable over H121 with an H2 pickup on the back of demand, limited supply and weather-related production disruptions.	2,439	2,514
Coffee (US$/tonne)	Prices have been rising on the back of tight global supply and increasing demand. Brazil's crop has been affected by frost and this is the main contributor to enduring price rises in the medium term.	4,200.	4,601
Palm Oil (US$/tonne)	Prices increased around 60% in H121 off demand recovery. As with all commodities, weather events and production constraints in major global producers, has underpinned prices. The forecast assumes some price moderation in 2022.	1,012	907

Source – Department of Treasury & KPMG Analysis

Fiscal strategy

GoPNG has shifted the focus to the longer term, with projections of a return to a balanced budget in 2027 on the back of inclusive growth and development.

Strategic Actions by 2034

1. Prudent, responsible and sustainable fiscal and monetary regimes – modernised tax administration with review and reform of tax systems to encourage fair and equitable taxes. Maintain debt and financial risk at sustainable levels. Develop domestic debt markets. Review of the Central Banking Act.
2. Transport infrastructure as an economic enabler – the state of the country's infrastructure will be improved through the Connect PNG Economic Transport Infrastructure Development Program 2020-2040.
3. Reliable and efficient ICT and communications network as an economic enabler – includes the EU STREIT project to build e-agriculture platforms to assist regional producers; and the PNG ICT cluster to develop local talent in the ICT space.
4. Clean renewable energy and safe water and sanitation as an economic enabler – includes the National Electricity Rollout Plan incorporating electricity infrastructure development, green renewable energy sources. The initiatives are strongly supported by international development partners and governments.
5. Renewable resources – enhance revenue through increased production, diversification and value addition – combat the negative impact of climate change on traditional subsistence agriculture, food and livelihood systems. Strong focus on increasing production; downstream processing and value addition in crops, forestry and fishing.
6. Extractive resources – enhance benefits through national content in local business participation, employment and community and environmental services – through various initiatives.
7. Local entrepreneurship - MSMEs, SMEs and commercial services – transform the small-scale sector to grow from 49,500 SMEs to 500,000 by 2030, growing the number employed in the sector by 1.7m to 2m employed.
8. Education for innovation and human talent development – investments in STEM education, support for Universities and Technical colleges. Support technological innovations in science, engineering, ICT and related fields.
9. Women empowerment, equality for all and anti-discrimination – women's economic empowerment will reduce family poverty; a stronger focus on gender equality and GBV. These initiatives will reduce the gender gap in formal sector employment.

The broad objectives of the fiscal recovery and repair program introduced in the 2021 Budget are to provide the platform for economic recovery and fiscal consolidation, while continuing with strategic capital formation necessary to sustain growth. In particular, the aim is to diversify the non-resource sector, expand the tax base and strengthen the efficiency of the delivery of public services. The following are the key principles:

- spend the money we have more wisely;
- raise the revenues more fairly;
- finance the debt more cheaply;
- leverage friendly international support more intelligently;
- focus on growth in the agriculture sector and the informal sector;

- distribute resource benefits more equitably;
- stimulate non-resource growth back to 5.0 per cent annually;
- comprehensive Government SOE reform program;
- free up foreign exchange; and
- create at least 10,000 jobs annually.

2022 Budget Strategy & Medium-Term Fiscal Outlook

Budgetary item	2021 S Budget	2022	2023F	2024F	2025F	2026F	2027F
Revenues & Grants	**13,675**	**16,190**	**17,686**	**19,556**	**21,847**	**24,606**	**27,768**
Operational Expenditure	10,299	11,099	11,199	11,631	12,424	13,523	14,796
Capital Expenditure	7,888	8,752	8,840	9,187	9,543	9,958	10,443
Interest payments	2,101	2,324	2,431	2,536	2,588	2,567	2,491
Budgeted Expenditure	**20,287**	**22,175**	**22,471**	**23,354**	**24,555**	**26,048**	**27,730**
Deficit	**(6,613)**	**(5,985)**	**(4,785)**	**(3,799)**	**(2,708)**	**(1,442)**	**38**
Debt to GDP Ratio (excl arrears)	**50.1%**	**51.9%**	**52.5%**	**52.6%**	**51.1%**	**48.9%**	**45.0%**

Source – Department of Treasury & KPMG Analysis

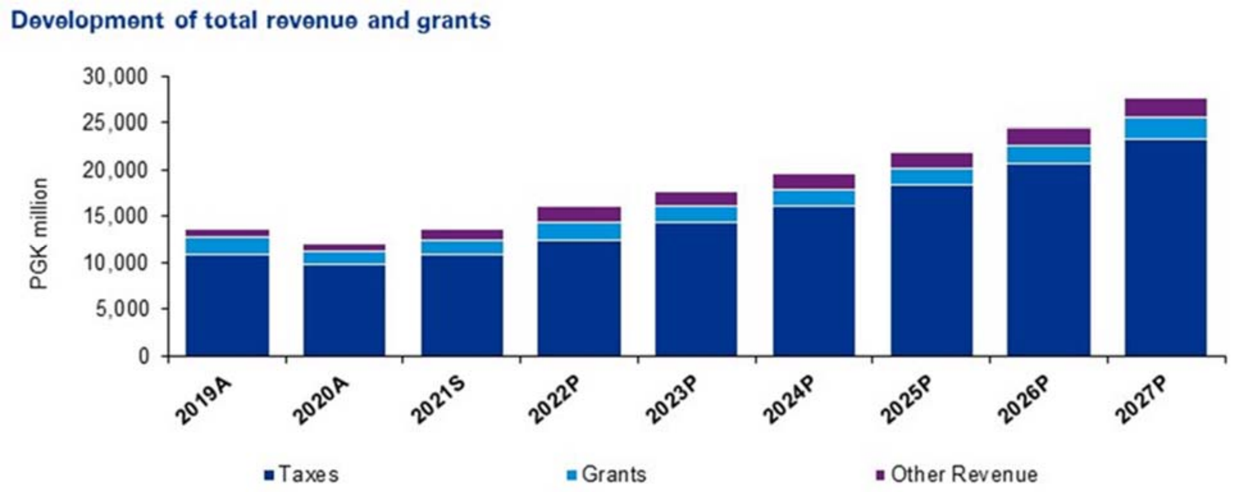
Key Insights

- A budget deficit in 2021 of 50.1% of GDP is expected to worsen in 2022 and 2023, before declining to a balanced budget in 2027. This is an optimistic medium-term outcome.
- 2022 is an election year and thus fiscal discipline may be difficult to maintain in the short term

Revenue

Total Revenue and Grants

The 2022 revenue forecast is K16.2bn representing an overall increase of 18.4% (K2.5bn) from the 2021 Supplementary Budget projection supported primarily by a rise in Mining and Petroleum taxes underpinned by higher prices for commodity exports. 2022 revenues are forecast to be supported by a rebound in economic growth through higher government spending, export price recovery, and growth in the agriculture, forestry and fishing sector.



Source – Department of Treasury & KPMG Analysis

Revenue assumptions for 2022 assumes a rise in tax revenue of 12.6% to K12.5bn.

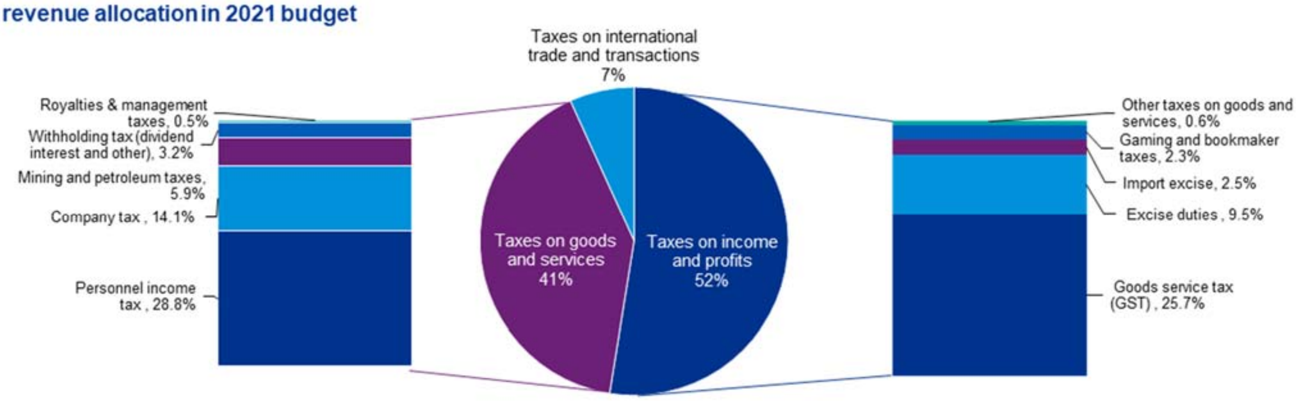
The flat business trends and the downtrend in mineral and petroleum commodity prices and the negative effects of the COVID-19 pandemic since March 2020 resulted in a K1.6bn decline of total revenue in 2020.

Driven by the increase in international commodity prices of key export products, the total forecast revenue in 2021 is expected to achieve the 2019 (pre-pandemic) level through the increased tax revenue and increased dividend income. We note that the outstanding K0.7bn dividend remains a risk for the current year.

At 1.8% of GDP it is clear that, although welcome, GoPNG does not expect to increase its dependency on grant funding the way it may have in the past. Development partners, such as the Asian Development Bank (ADB), European Union (EU), Australian Aid and others are expected to get on board and provide support through slightly increasing grant allocations going forward with a mid-term plan at 1.5% of GDP.

Tax revenue comprises 79.5% of the overall revenue budget and 12.3% of GDP. The composition of the total revenue and grants for the 2023 Budget is presented in the chart below:

Tax revenue allocation in 2021 budget



Source – Department of Treasury & KPMG Analysis

The forecast assumes a rebound in economic growth (in both the mining and non-mining sectors), higher government spending and private sector credit growth and the further increase in export commodity prices.

Personal income tax (PIT) is projected to increase by K248m (7.4%) to K3.6bn underpinned by:

- easing the COVID-19 restrictions and supporting businesses reinstate hiring;
- the increased compliance activities undertaken by IRC; and
- the anticipated restart of the Porgera and Simberi mine.

The prohibition of the credit off-set against salary or wages tax liabilities will remain in effect, supporting the cash flow position of the Government.

The minor increase (K64m or 3.8% slightly) in company income tax (CIT) does not seem to be unreasonable considering the easing of restrictions and the expected rebound of the economy. However, it is noted that the 2021 supplementary budget target collection may not be achievable which suggest that IRC needs to increase its compliance activities to achieve the target in 2022.

Mining and petroleum tax (MPT) receipts expected to increase by 41.8% to K738m in 2022, close to the pre-pandemic level in 2018 and 2019. The projection reflects gradual improvement in the international price expectations for oil and gas in 2022.

There is no indication from what time and with what associated revenue the Government calculated with the reopening of the Porgera and the Simbu mines.

Taxes on Goods and Services (including GST and excise duty) is projected to increase significantly from the 2021 supplementary budget (23.5% or K968m). This reflects a full recovery of the business activity and improved economic conditions following the ease of the restrictions.

We note the projected increase in excise duty (K184m or 18.4%) as a result of continuing increase (but slower pace at 2.5% per half year) in tax burden and pick-up of the consumption of excisable items.

Under other revenue, dividends from mining, petroleum and gas areas, (specifically K400m from Kumul Petroleum Holdings and K450m from the OkTedi mine) represent the major revenue source contributing 67% of total dividends and K200m increase. Furthermore, the K0.7bn increase from the 2021 supplementary budget is driven by the additional K146m expected from the National Fisheries Authorities.

Additional revenue in the form of a market concentration levy of K195m (payable by BSP) and K90m (payable by Digicel) is expected from the banking and telecommunication sectors which we assume is included in company tax.

The Government's revenue target, excluding grants, is to reach 16.0% of nominal GDP by 2025, above the 14.1% target for 2022 in the current MTRS. The higher revenue growth rate compared with the nominal GDP growth rate reflects expected improvements in efficiency in the tax collection system with a greater share of the revenue mix coming from resource projects.

We note that the Government revised its growth strategy compared to the 2021 Budget and increased the revenue projection by 7.5% for 2022 and 3.8% for 2023 and 2024. This reflects the recovery of the economy in short-term.

Key Insights

- The year-to-date collection data for CIT and GST indicates that the 2021 Supplementary Budget may not be achieved. This and the higher tax revenue targets for 2022 may lead to higher activity from IRC.
- Due to the COVID-19 restrictions there have been fewer inspections and compliance activities undertaken by the IRC impacting 2021 revenues. The Budget projects higher revenue through increased IRC compliance and collection activities in 2022. With the confirmation of the new 'delta variant' cases the pandemic may pose an increased risk for the projected increased tax collection.
- We note that the vaccination rate in PNG remains low (below 5%) maintaining international travel restrictions for PNG. The current pandemic and turbulent market is expected to stay with us in 2022. This may undermine the growth expectations and is considered as a major risk to the budget.
- While Government is not heavily dependent on grant funding there is room to obtain more grants by demonstrating good project management and project delivery on the ongoing grant projects. We note an increased capacity of the donor agencies, and more resources becoming available in mid-term.

Expenditure

Total expenditure and net lending in 2022 is budgeted at K22.2bn. This represents a budget deficit of K6.0bn based on the revenue projection of K16.2bn, which will be funded through the internal revenue (K12.5bn), grants (K1.8bn) and other revenue (K1.8bn). The deficit of K6.0bn is expected to be financed through external and domestic borrowings.

The total projected expenditure of K22.2bn is comprised K19.3bn Government expenditure (operational expenditure and capital investment from own source), and additional capital investment of K1.3bn and K16bn from concessional loan and donor support grants, respectively.

The operational budget has increased by 10.6% driven by:

- The increase in the Goods and Services budget. This increase takes into account the government arrears (utility bills, rentals, Superannuation and retirement costs) and the costs associated with the 2022 National General Elections.
- The increase in Compensation of employees by 5% to cater for the increased salaries and allowances and excludes benefits such as superannuation.

2022 capital expenditure budget increased by 17.4% from the 2021 budget to ensure:

- On-going projects are financed for completion in 2022
- Maintaining the funding of fixed commitments of key policies and priorities such as the support improvement programs (SIPS) and Connect PNG Policy.

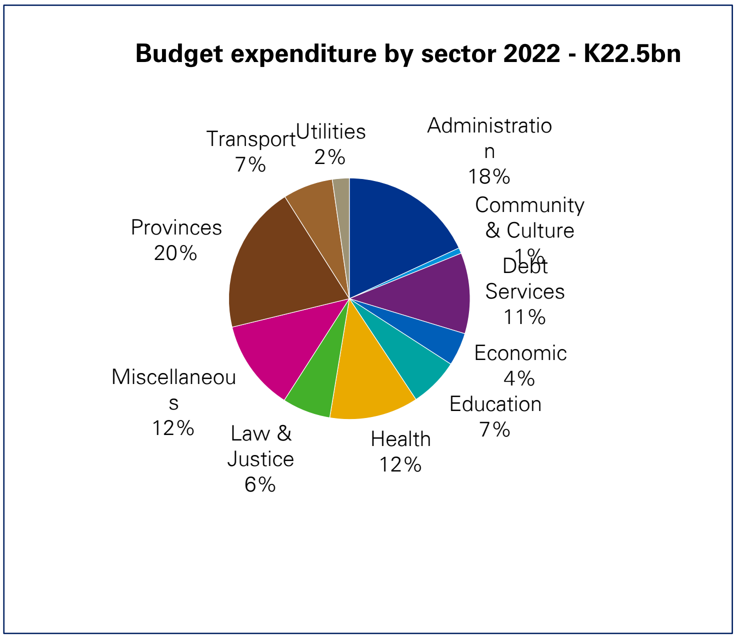
Critical projects geared towards PNG's social and economic development have also been considered in the 2022 new projects.

Budget Component (Km)	2021 Supp Budget	2021 Budget	2022 Budget	Change
Compensation of Employees	6,030	5,764	6,050	4.97%
Goods & services	3,058	2,789	3,733	33.83%
Provincial Function Grants	584	584	594	1.70%
Debt (interest repayment)	2,101	2,271	2,324	2.36%
GST & Book Makers	626	729.2	721.9	-1.00%
Total Operational	**12,400**	**12,137**	**13,423**	**10.60%**
GoPNG	4,824	4,824	5,858	21.43%
Donor Support Grants	1,425	1,008	1,575	56.24%
Loans	1,638	1,638	1,318	-19.53%
Total Capital	**7,888**	**7,471**	**8,752**	**17.14%**
Total Expenditure	**20,287**	**19,608**	**22,175**	**13.09%**

Source - Department of Treasury & KPMG Analysis

The Government implements expenditure efficiency measures through the implementation of Non-Financial Instructions (NFIs) and reviews their implementation status on quarterly basis. These NFIs are for performance improvement and address compliance issues, set primarily for the National Department of Health, the Conservation and Environment Protection Authority, the National Agriculture Quarantine Inspection Authority, Department of Finance and Department of Provincial and Local Government Authority.

The Government will continue to undertake payroll efficiency activities and target a coordinated whole of Government workforce plan to regulate the growth of the public sector. K200m is allocated for the public service retirement exercise in 2022, to facilitate the retirement of 575 public servants in 2022.



Source – Department of Treasury & KPMG Analysis

Expenditure by Sector (Km)	Operational	Capital	Total	% of total	Comment & major projects
Administration	805	3,078	3,883	18.1%	General election (K600m), Goods & Services arrears (K300m), Retirement Fund (K200m)
Community & Culture	70.7	90.3	161	0.8%	Various small projects
Debt Services	2,324	-	2,324	10.8%	
Economic	257.6	690	948	4.4%	Aim of renewable sub-sector support is to increase exports of commodities and promote downstream processing. Non-renewable focus is on downstream processing.
Education	1,220.6	196.9	1,418	6.6%	GTFS (K632m) is the primary focus with infrastructure and rehabilitation projects funded.
Health	1,478	1,076.9	2,555	11.9%	"Back to Basics" approach continues from prior year. Flagship programs include Enga General hospital (K156m), 19 Provincial hospitals development (K285m) and PMGH Cancer facilities upgrade project (K50m).
Law & Justice	1,161	224.8	1,386	6.5%	For Justice - infrastructure development including Waigani National Court. For Defence - air capability, new Hela barracks & defence infrastructure programs
Miscellaneous	2,606	-	2,606	12.1%	no comment in Budget
Provinces	2,541	1,708	4,249	19.8%	Continued focus on improved service delivery
Transport	200.8	1,238	1,439	6.7%	ConnectPNG Roads (K500m), Nadzab Airport Terminal (K182m). Development partner loans and grants to assist
Utilities	37.4	449.3	487	2.3%	National energy rollout plan, NBN Project, Town electrification Investment Project and others.
Total expenditure	*12,702*	*8,752*	*21,454*		
GST & BMT	721.1		721		
Total expenditure	**13,423**	**-**	**22,175**		

Source – Department of Treasury & KPMG Analysis

Key Insights

- Expenditure overall grew by 13.1% to K22.2bn and will need to be financed by a K6bn budget deficit. Whilst this is 10% lower than in 2021, overall debt rises to a debt to GDP at 51.9% (1.8pp. increase) for 2022.
- Operational spending is forecast to grow by 10.6% and capital spending by 17.1%. This focus on investment and growing the capital base is encouraging, particularly the focus on small and medium enterprise support initiatives.
- Sectoral allocations appear reasonable with a strong focus on developing a sustainable economic base.

Budget financing

The focus is on debt sustainability with concessional external financing sources and domestic debt instruments amongst others.

The 2021 budget deficit was K6.6bn to be financed through domestic debt borrowings of K2bn and external borrowing of K4.6bn. GoPNG received K950m from JICA budget support loan, K526 from world Bank EDPO and K2bn from Treasury bonds issued. K1.25bn is expected to be financed by an IMF SDR allocation and other sources.

The 2022 Budget will require a deficit of K5.95bn to be financed and the approach will target the same sources of funding including the Australian Infrastructure Financing Facility for Pacific; ADB State Owned Entity budget support; and the drawdown of existing concessional loan facilities. Amortisation of liabilities will save GoPNG on interest costs. Net issuance of Treasury Bonds is expected to be K1.75bn and K421m of Treasury Bills. The financing requirement will push total government debt to K52.7bn by year end – 51.8% of GDP. Domestic market participants will be important in providing the required liquidity – primarily the commercial banks and superfunds.

Budget Financing (Km)	2020	2021	2022	% of total	2023
Domestic					
Treasury Bills	11,902	11,019	12,662	24.0%	13,481
Treasury Bonds	9,233	11,263	12,583	23.9%	14,083
Domestic Loans	1,081	975	1,210	2.3%	1,240
Total Domestic	**22,216**	**23,257**	**26,456**	**50.1%**	**28,805**
International					
External Debt Securities	1,701	1,701	1,700	3.2%	1,700
Concessional loans	9,832	10,773	11,643	22.1%	12,505
External Commercial loans	1,094	149	136	0.3%	94
Extraordinary loans	5,326	10,585	12,831	24.3%	14,447
Total External	**17,953**	**23,208**	**26,309**	**49.9%**	**28,746**
Combined total	**40,169**	**46,465**	**52,765**		**57,550**
% of GDP	49.2%	51.5%	51.9%		52.5%

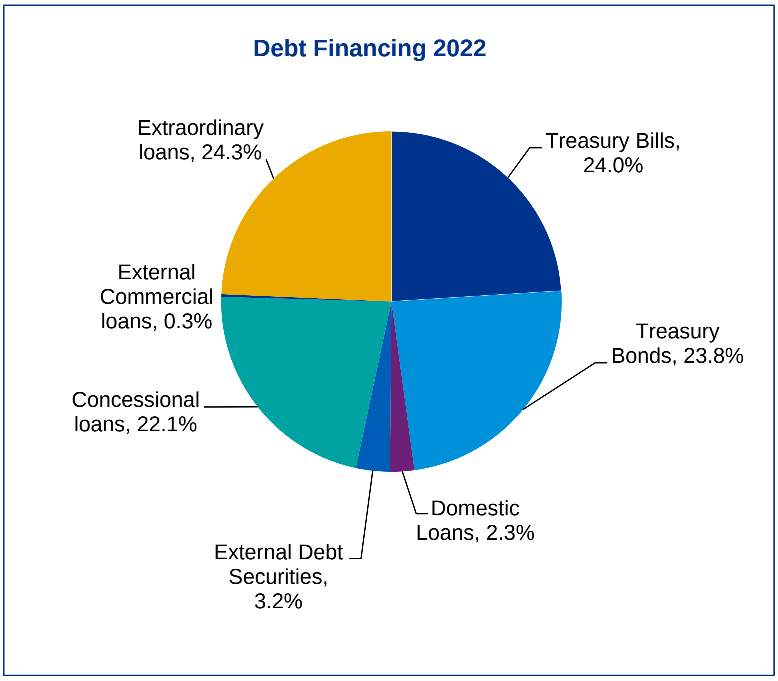
Source: Department of Treasury & KPMG Analysis

Over the longer term GoPNG aims to maintain debt at sustainable levels and maintain financial risks at prudent levels to maintain macro-economic stability and build confidence in the economy.

The broad strategies to achieve this are:

Maintain debt at sustainable levels, within the 45-60% debt to GDP band. 52% level is expected for 2022, rising to 53% in 2023 and 2024 before reducing to 45% by 2027.

Maintain financial risk at prudent levels by seeking low interest rate external loans given the higher cost of the domestic debt market. Total interest as a percentage of 2022 revenue is estimated to be 17.5%, down from 20.3% and gradually declining to 9.7% in 2027.



Source – Department of Treasury & KPMG Analysis

Key Insights

- The budget deficit in 2022 is forecast to be lower than the 2021 deficit but the gap between the proposed financing instruments and the deficit is concerning.
- GoPNG has taken advantage of the concessional loans in terms of availability and cost and looks to continue this strategy - the domestic market has provided valuable liquidity but is more expensive.
- A key strategy will be to broaden and deepen the domestic debt market to allow a more liquid and efficient secondary market.

"2022 sees little change but brings big controversy"

Tax - General

Major blow to the dominant bank and telco players

Market Concentration Levy

While there have been few taxation changes impacting the 2022 calendar year, the introduction of the Market Concentration Levy is possibly amongst the most contentious changes in recent years. The Market Concentration Levy is the outcome of the Banking Levy and Telecommunication Levy mooted in the previous two Budgets. However, the industry consultation processes promised in previous Budgets either did not take place or were rushed and not comprehensive in nature. Singling out and impacting only the two dominant market players, and being so unduly harsh in nature, this new levy seems counterproductive and does not promote economic recovery.

The rationale provided for this levy is that there is a significant risk that the dominant player in the market could collect super-normal profits.

Despite its challenges PNG has had a relatively stable tax system in previous decades which made it a relatively predictable investment location from a tax perspective for foreign direct investment. Crippling tax charges such as these, and without consultation, have the potential to harm rather than to encourage foreign investment.

Banking

The levy applies to banks holding more than a 40% market share, being BSP bank.

The levy will be imposed by way of an additional tax of K190m for each financial year commencing in 2022 provided it is in a taxable position. This levy is not tax deductible to the bank and will be collected through the provisional tax instalment system.

Telecommunications

The Market Concentration Levy has been imposed on Digicel, being the only telecommunications company currently holding more than a 40% market share.

The levy will be imposed by way of an additional tax of K95m for each financial year commencing in 2022 provided it is in a taxable position. Again this will be collected through the provisional tax system and will not be tax deductible to the company.

Infrastructure tax credits

2022 will see the increase of the infrastructure tax credit from 0.75% for the extractive sector and 1.5% for the agriculture sector to 2%. The increase is aimed at encouraging more physical infrastructure in the project areas. It will be mandatory for developers to submit their expenditure reports directly to the IRC. The carry forward period for excess expenditure will be limited to seven years, in line with the loss carry forward period. Taxpayers may only claim the credit for completed projects and only taxpayers in taxable positions may participate in the scheme.

Alignment of legislation with Tax Administration Act

A new Income Tax Act is expected to be introduced with effect from 1 January 2023 although the new Act is currently still being drafted. What was initially mooted as a simplification process has turned out to potentially include some significant policy changes.

The current regime of disjointed, overlapping rules for imposing tax liability, with its complex rules on priority, are to be replaced by a slate of six discrete taxes. These are income tax, small business tax, salary or wages tax, non-resident tax, international transportation income tax, and capital gains tax.

The transition from the old Act to the new Act is expected to be managed by allowing the old Act to apply to tax years prior to 2023. Some provisions in the new Act require transitional rules to be introduced and Treasury have previously indicated these will be introduced through Regulations.

As many of the administrative provisions will be dealt with through the Tax Administration Act 2017 (TAA) rather than the new Income Tax Act this Budget proposes several housekeeping measures to enable the eventual coming into operation of the TAA. The TAA will come into operation upon release of a Gazettal Notice. These housekeeping measures impact income tax, GST, Gaming Control Act, Stamp Duty and Departure Tax and will also come into effect through the issue of a Gazettal Notice.

Key Insights

- While the Market Concentration Levy may fill an immediate hole in the revenue reserves this may be far outweighed by the long term consequences for investor sentiment in PNG.
- Despite Treasury claims to the contrary, consumers and superannuation members may be the ultimate losers when it comes to the imposition of the levies on the banking and telecommunications industries.
- Government seek to encourage the further outsourcing of infrastructure obligations to the private sector through the increase in the infrastructure tax credit.

International trade and customs

Alcohol and tobacco industries and petroleum importers are the major winners in this Budget

Imported refined petroleum products

The customs duty on imported refined petroleum products (diesel and petrol) will be reduced from 10 toea to 5 toea in 2022 and further reduced to a zero-duty rate in 2023. This will reverse the tariff introduced in the 2018 Budget. Its removal is aimed at increasing competition in the market and to lower retail prices. This measure is expected to reduce revenue by K24m in 2022 and again in 2023.

UHT milk

The 25% customs duty imposed on imported UHT milk in the 2019 Budget was not actually implemented due to a shortage of locally produced milk supplies. This tariff is removed effective 1 January 2019.

Tobacco products

From 1 December 2021 the six-monthly indexation rate will be reduced from 5% to 2.5% to provide relief to the tobacco industry. The excise duty rate will increase by 2.5% at six monthly intervals on 31 May and 30 November each year.

The second-tier tobacco excise on cigarette products will continue to apply for another two years (2022 and 2023) with the aim of revenue raising and limiting the level of illicit tobacco in PNG.

Alcohol products

Relief is also being provided to the alcohol industry by reducing the six-monthly indexation rate from 5% to 2.5% from 1 December 2021. The excise duty rate will increase by 2.5% at six monthly intervals on 31 May and 30 November each year. This measure for both alcohol and tobacco products is expected to reduce revenue by K40m.

From 1 December 2021 the excise rate for mixed drinks of strength greater than 10% alcohol content will be increased from K689.66 to K789.66 per litre of alcohol. The rate will be increased by 2.5% at six monthly intervals on 31 May and 30 November each year.

Electric vehicles

As a nod towards the green economy no import taxes will apply to electric vehicles from 1 January 2022.

Key Insights

- Some surprise reductions in excise on tobacco, alcohol and imported petroleum products.
- Perhaps as a nod towards the recent COP26 import taxes are to be removed on electric vehicles although it will likely be many years before PNG has the facilities to use and charge them.

Announced measures not yet enacted

The government has flagged further measures

	New policy development areas not yet implemented
1	The Medium-Term Strategy Review (MTRS) 2018-2022 introduced in 2017 based on recommendations from the IMF will be reviewed in 2022 with the aim of developing a new strategy for 2023-2027.
2	The re-write of the Income Tax Act 1959 is yet to be finalised. It will likely be introduced in 2023.
3	Review in 2022 of regulatory environment and fiscal incentives to encourage investment in the PNG IT sector. Stakeholders include Treasury, Department of Information, Communication and Technology, NICTA, PNGCS, IRC and others.
4	Review in 2022 of the list of prescribed areas availing of the ten year tax holiday provided to new, mostly agricultural, businesses availing of Rural Development Incentives. Stakeholders including Treasury, National Economic and Fiscal Commission and IRC to be consulted.

	Compliance measures announced
1	GMS software to be procured, installed and trialled in 2022 beginning with the retail sector. This will involve the installation of GMS software in all wholesale and retail counters with the aim of capturing GST collections at point of sale and in real time.
2	The Integrated Tax Administration System (ITAS) will be commenced in 2022. ITAS should provide real time access to a taxpayer tax account, online filing of returns, online registration, online payments, case management, business intelligence and ability to interface with IPA, Customs and banks.
3	A Container Examination Facility to be built in 2022 in Lae. With combined advanced x-ray technology and physical inspections, it is expected to reduce the flow of contraband goods, improve compliance and broaden revenue base.

	Non-tax revenue measures announced
1	A new Non-Tax Revenue Administration Bill 2021 will be implemented in 2022 to replace the Public Money Management Regularisation Act (PMMRA) 2017 which was previously deemed unconstitutional.
2	The e-Lands and Go-Lands systems will be further rolled out together with e-Lands kiosks to improve revenue collections.

CFO / Head of Tax checklist

Leaders within finance and tax functions should consider the impact of the following measures as a priority.

	Detail	Checklist
1	**New Income Tax Act - 2023** • Although not yet finalised keep a watch on developments with the new Income Tax Act and consultation process during 2023. This new Act will include some key policy changes. Consider, as a priority, any tax planning which may need to be done in advance of its introduction.	☐
2	**Market Concentration Levy** • While currently just applicable to BSP and Digicel, other players should consider their own market share and whether or when they may reach the 41% threshold.	☐
3	**Retailers and wholesalers** • Consider the impact of the new IRC GMS software system which will capture GST collections by your business.	☐
4	**IRC records** • All taxpayers should bring their tax records up to date in preparation for the move to the new ITAS system.	☐
5	**Tobacco and alcohol** • Consider impact of excise changes.	☐

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