



**Speech by Hon. Sir Mekere Morauta, Kt MP
Prime Minister and Minister for Finance and Treasury**

on the occasion of the presentation of the 2001 Budget to Parliament

Tuesday 28 November 2000

From Recovery to Reconstruction

Mr Speaker, Honourable Colleagues, Fellow Papua New Guineans,

When we made our date with destiny in July 1999 our country was in deep crisis. My Government immediately set to work to halt that crisis, and lay the foundations for reconstruction and development through stability and growth. The Supplementary Budget brought down in August last year was both the first tool my Government had and our "Last Chance" to stop the slide.

"Road to Recovery" was how I described the 2000 Budget when I presented it last November. We have travelled quite a way along that difficult road. While there is further distance to go, the progress we have made allows us to turn our minds in 2001 to reconstruction of our nation.

2002 will be a year of consolidating that reconstruction process, and when real gains in social and economic development might be seen.

Mr Speaker, our people once again have a measure of confidence in their Government. The world has confidence in my Government. Success in the recovery and reform process we have systematically set in train will restore even greater confidence in our country.

What better report can I make, than that the planned outcomes set in the 2000 Budget have been achieved, or are within sight:

- The monetary and financial systems have been reconstructed and stabilised.
- Responsible and prudent budgetary management has been successfully implemented.
- Expenditure control measures are containing total disbursements within the original appropriations.

Success in these areas has allowed us to provide people some relief from the financial hardship endured since 1997.

The 2001 Budget provides further relief. Low-income workers, all earning less than 16,000 kina a year, will pay less tax. Provision has been made for further increases in public sector wages, supplementing the modest rises given this year. And, like the 2000 Budget, this budget does not impose any new revenue measures.

Once again, Mr Speaker, the Government is bringing down a budget that is, to all intents and purposes, a balanced one.

In 2001, shifting expenditure towards the priority areas of health, education, law and order, primary industry and infrastructure, including maintenance, will continue.

Mr Speaker, the 2001 Development Budget is allocated a record share, 35 per cent of total expenditure. This means more money will be spent on roads, bridges, aid posts, schools, and all the other services that make a real difference to the lives of most people.

I am greatly encouraged by people's appreciation of the economic gains we have made. All of us have welcomed the sharp reduction in inflation, while businesses in particular are benefiting from a more stable policy environment and from reduction in interest rates.

Although the economic environment remains depressed, mainly due to low agriculture commodity prices and a very high oil price, prudent economic and financial management has resulted in the Government meeting the 2000 Budget targets. This is a remarkable achievement.

As the economy recovers, employment growth will of course naturally follow. Gross Domestic Product (GDP) is projected to grow by 3.1 per cent next year, by 5.7 per cent in 2002 and by 8 per cent in 2003. But the precondition for realising these strong economic growth figures is continuation of the reform agenda.

Responsible economic and financial management by the Government has stabilised the kina. Last Friday the kina closed at 33.80 US cents. Compare this with the rapid plunges and artificial gains the kina experienced in 1998 and the first half of 1999, hitting 27.25 US cents, the lowest traded level ever, just prior to our election.

The level of foreign exchange reserves has increased markedly since we came to office. When we took over only 89 million US dollars were left in the coffers of the Bank of Papua New Guinea. We have trebled that figure. The level of foreign exchange reserves now stands at 279.5 million US dollars.

Interest rates, which in June 1999 went above 28 per cent on 182-day treasury bills, are now averaging just over 14 per cent, a reduction of 50 per cent. Banks have begun lowering their lending rates.

Inflation, which in 1998 was 22 per cent, has for the last year to September been 12.2 per cent.

These are most significant achievements in the context of where we were 16 months ago.

Mr Speaker, I do regret however, that I have been forced to defer the final vote on the political integrity and stability bills. We have improved public finance management dramatically, which in turn has positive economic effects, but the failure to provide the nation with the political stability necessary to entrench those gains has let down our people.

However, I make a firm commitment to everyone to push on with this essential constitutional change, change which I believe will be our biggest investment in our future.

What we have achieved has been made possible by the hard decisions my Government made from the outset and by our strategy for recovery and reconstruction. It is a strategy that we designed and we are implementing, as fast as is possible.

I am encouraged by the international commendations of the Government's substantial achievements to date. The International Monetary Fund, the World Bank, the Asian Development Bank, Australia, Japan and the other Friends of Papua New Guinea have all assisted us in pulling away from the edge of the economic precipice.

The international financial institutions and donor countries have endorsed and supported the economic management strategy that provided the framework for the 1999 Supplementary and the 2000 Budgets. This, the 2001 Budget, once again, fully reflects that clear and well-articulated strategy.

Mr Speaker, the damage inflicted on the economy by our predecessors has had very profound negative consequences. While recovery began as soon as my Government took office, full recovery will take time, and consistent, well-orchestrated effort.

We must build on the gains of the last sixteen months, to ensure that the recovery is sustained and that the goals that we have set are achieved. The 2001 Budget therefore is designed to capture and cement the gains.

Mr Speaker, the Structural Reform Program set out in the 2000 Budget has been the Government's guide through 2000 and is leading us again through 2001. New reform initiatives are being introduced in the 2001 Budget to pursue the key objectives of the Program rigorously and systematically. These objectives are to:

- Improve governance;
- Sustain macroeconomic stability;
- Improve public sector performance; and
- Remove barriers to investment and economic growth.

The new measures will build on the progress that has been made in 2000. I would therefore like to give an overview of the reform process to date and of the new initiatives that form the next phase of our agenda.

Mr Speaker,

This Government has worked hard to improve governance and has restored integrity to our great institutions of state.

The public sector is now displaying signs of being a very different place to work than it was prior to July 1999. Bureaucrats know that the law must be upheld and that their opinions and voices will be seriously considered.

An orderly process of government decision-making has added to the morale and quality of output of our public servants.

All matters to be considered by the National Executive Council are vetted by the Central Agencies Co-ordinating Committee (CACC). The result is more balanced and better considered advice being put to the Government, as all the relevant inputs have been incorporated. The days when Cabinet deliberated on haphazardly prepared submissions have gone.

In order to improve the management of the public service the CACC and the Chief Secretary will assume responsibility for enforcing implementation of departmental work plans and financial discipline.

Mr Speaker, it is our duty and responsibility to fight against misappropriation, graft and corruption and those involved. These selfish acts became a way of doing business before this Government's formation, and their legacy is clear to see in many of the problems we face today. Toward this end the Government is strengthening the overseeing role of the relevant agencies: the Auditor-General, the Ombudsman Commission and the Attorney General. All will receive additional funding in 2001.

To ensure honesty and greater efficiency in Government procurement, the Central Supply and Tenders Board has been strengthened in 2000 and will be further strengthened in 2001.

The Parliamentary Accounts Committee must become more active and involved, as is its right and duty. Mr Speaker, it is up to Parliament to initiate a revival and strengthening of this Committee's role.

These measures, coupled with the substantive increase in funding to the police in 2001, give me hope that 2001 might be *The Beginning of a Return to Law and Order*.

Mr Speaker,

Public sector reform is a crucial building block for improving the delivery of services and our welfare. We must succeed. We must improve our low levels of health, education, transport links and law and order. At the same time, higher productivity and efficiency must be achieved.

Completing the process of reforming the public sector will take three to five years. We have made a positive start in 2000 by reviewing departments and agencies with immediate needs. We have reviewed Defence, Foreign Affairs, Fisheries and Civil Aviation, and the reform measures have been included in the 2001 Budget.

The process of departmental review will continue in 2001 and the recommendations will be included in the 2002 Budget.

We have made a bold initiative by requesting the Commonwealth Eminent Persons Group to undertake the first serious structural review of the Defence Force. Implementation of the Group's recommendations will proceed early next year. I have every confidence that the result will be a refocused, proud, disciplined Force, capable of rapid response and of contributing more effectively to nation-building.

Mr Speaker, privatisation is a cornerstone of the Government's strategy to make the economy more efficient and, not least, to reduce the scope for fraudulent and criminal activity in the public sector.

We have made significant progress in 2000 in establishing the institutional framework for privatisation and developing a strategy for privatisation. A notable success has been the advance in bringing the Papua New Guinea Banking Corporation to the point of sale.

Let me reiterate the reasons why we need privatisation and why Papua New Guinea will benefit from it.

The facts are that:

- State-owned enterprises have performed far below reasonable expectations and hopelessly below their potential.
- The costs of their services represent poor value for money by international standards and the service provided by many of them is poor.
- The State has borrowed and continues to borrow at high cost to keep state-owned enterprises out of bankruptcy, and most are not even repaying the interest on their debts to Government.

It is time we faced up to the facts. *Government is not good at operating commercial enterprises.*

To ensure that privatisation benefits the great majority of the population, the Government is reviewing the regulations for delivering essential services. This review focuses on the importance of protecting consumers and ensuring that service coverage is maintained and where possible improved.

We will be seeking to ensure maximum competition. That is by far the best way to ensure efficient performance. We will introduce a liberal trade and investment environment in which a competitive private sector operates on an even playing field. Where the level of competition is low, we will establish a clear, unambiguous legislated regulatory framework to ensure that service providers do not take unfair advantage of monopolistic powers. We will establish what the Community Service Obligations are for each industry and ensure that they are provided at the least cost to the public purse.

The 2001 Budget provides further funding for the Privatisation Commission to continue its work. The Commission has commenced the preparation of Air Niugini for sale and will soon appoint project managers to prepare the other major state owned enterprises. This process is being carried out in a transparent and accountable manner.

Mr Speaker,

The reform of the financial sector is now well advanced through the introduction of four Acts of Parliament:

- The Central Banking Act 2000;
- The Banks and Financial Institutions Act 2000;
- The Superannuation (General Provisions) Act 2000; and
- The Life Insurance Act 2000.

These latter two bills will be presented to Parliament before the adjournment.

The Central Bank will have the powers to licence, regulate and supervise all financial institutions. This fills the supervisory vacuum that has existed for important institutions in the sector. The financial sector will operate in a stable regulatory environment, but without the day-to-day Government intervention that proved so disastrous in the past.

Many of these institutions have been hijacked by vested interests, thieves and cronies. The prime examples are of course the National Provident Fund and the Motor Vehicle Insurance Limited. The plundering of these institutions in past years is a sad and shameful betrayal of the people of Papua New Guinea. I have promised that all cases of abuse will be investigated. Those found guilty of criminal activities will face the full force of the law.

Mr Speaker,

The Government must continue with measures to sustain macro-economic stability. There are several reform measures that impact on the fiscal operations of the Government, the performance of the budget and the outlook for 2001 and beyond. These include:

- Implementing the recommendations of the Taxation Review;
- Continuing to improve expenditure monitoring and control in order to reduce waste of public funds;
- Improving debt management to reduce financing costs and ensuring the preclusion of arrears in Government payments; and
- Increasing the size of the Public Investment Program and continuing to shift expenditure from low priority to high priority sectors.

Mr Speaker, the 2001 Budget takes us further in the direction set by the Supplementary Budget of August 1999 and the 2000 Budget. The same principles of responsibility, transparency and effective control underlie all of these budgets.

A major objective of the 2001 Budget and the reform program is to entrench fiscal responsibility. In addition, macro-economic stability will be consolidated through continuing sound and prudent policies.

Mr Speaker, before turning to the details of the 2001 Budget, let me report on the outcome for 2000. This is the first time in many years that the budgetary outcome actually reflects what the National Parliament approved.

The deficit in the 1999 Supplementary Budget was 232.3 million kina, or 2.6 per cent of GDP. This was a great achievement, considering that when I took office five months earlier it was running at an annualised level of 5 per cent of GDP, or 446.7 million kina.

Included in the final deficit for 1999 was an amount of 148.9 million kina to settle arrears. The underlying deficit was thus only 83.4 million kina, or 0.9 per cent of GDP.

The 2000 Budget deficit is projected to be 137.1 million kina, or 1.4 per cent of GDP. In 2000 we have had to settle arrears of around 125 million kina, and the one-off structural adjustment expenditures of 101 million kina are also part of the deficit.

When these extraordinary payments are excluded, the 2000 Budget is in surplus.

In 2001, the planned deficit for the year is 140.9 million kina, or 1.3 per cent of GDP. This is much lower than the 215.1 million kina deficit forecast for 2001 when the 2000 Budget was framed.

Mr Speaker, the Government, in its short term in office, has had to budget and pay for arrears of around 320 million kina. These arrears are expenditures undertaken by previous governments but not paid for. The arrears we have inherited are equivalent to 8 per cent of the total appropriation of the 2001 Budget, or 15 per cent of the estimated non-mining tax revenue.

This situation highlights the necessity and strong incentive for Government to prepare realistic budgets and to ensure effective expenditure control, to avoid building up of arrears.

Again in 2001, it has been necessary to provide some 61.5 million kina for emerging conditional arrears of previous Governments. In addition, 65.8 million kina is provided for one-off structural adjustment payments that will support the Structural Reform Program in 2001. Therefore, the underlying deficit is only 13.6 million kina. For all intents and purposes the budget is balanced.

Mr Speaker, this Government will continue to reduce domestic debt. We have already reduced the unacceptably high level of government debt held with the Bank of Papua New Guinea, which threatened us with economic disaster in mid-1999. We have reduced debt held with the Central Bank by just under 1.2 billion kina. Another 267.9 million of domestic debt will be repaid in 2001.

This is a major restructuring of the public finances. It has allowed for shifts of expenditure in 2000 and 2001 toward priority areas.

From 1999 to 2001, the total appropriation, including recurrent and development appropriations, to:

- Health was increased from 184.7 million kina to 280 million kina, an increase of 51.6 per cent; to
- Education from 506.1 million kina to 596.3 million kina, a growth of 17.8 per cent; to
- Law and Order from 199.8 million kina to 263.4 million kina, an increase of 31.9 per cent; and to
- Infrastructure from 295 million kina to 404 million kina, growth of 36.9 per cent.

In 2001, 193.3 million kina of the funds for infrastructure is for maintenance. These funds will enable a very big effort in rehabilitating and improving our roads, airstrips and bridges, especially in rural areas. The allocation for road maintenance is 141.3 million kina. This includes a major maintenance program for the Okuk Highway and for all Highlands provinces. Improved roads will make it possible for people to bring higher volumes of coffee and other produce to market, and easier for government services to reach people in outlying districts.

The composition and distribution of expenditure in the 2001 budget is beginning to reflect the Government's policies and is becoming more efficient. Excluding debt service payments, the total appropriation in 2001 is 2962.3 million kina and of this:

- The share for Health is 9.4 per cent;
- For Education, 20.1 per cent;
- For Law and Order, 8.9 per cent;
- For Infrastructure, 13.6 per cent; and
- For the Economic sector, 5.2 per cent.

The priority sectors will receive 57.3 per cent of the total appropriation, excluding debt service, in 2001.

Although we have been successful in delivering a significant redistribution of resources to priority sectors in a very short time, further implementation of the Structural Reform Program will allow us to do more.

As I promised in my previous budget speech, the 2000 and 2001 budgets address basic development objectives and needs, and will help move our people steadily towards a better life in the 21st century.

- Everyone should have adequate food and clean water to drink, decent health and education and safety from crime.
- Everyone should have opportunities to earn income.
- Everyone should have access to transport and communication so that they can get their products to the markets and they can understand and profit from today's changing world.

This was and remains the vision and duty of this Government.

Mr Speaker,

The 2001 Budget incorporates virtually all the recommendations of the Taxation Review. Members of Parliament and the public will find the full details in Volume 1, Chapter 5 of the Budget documents.

Adoption of a main recommendation of the Taxation Review, relating to *easing the income tax burden for low-income earners*, should be welcomed. The tax-free threshold is being increased by 37.5 per cent, from 4000 to 5500 kina.

This will be a welcome relief for low-income earners, who were particularly adversely affected by the increases in prices caused by the previous Government.

In order to ease the burden on those who work overtime, the first tax band has been widened. It now stretches from 5500 to 16000 kina, so that many taxpayers will pay the same rate of tax on their regular employment and their overtime employment.

The overall effect of the personal taxation changes is revenue-neutral, with a marginally heavier burden on high-income earners, as a result of some increase to the taxation of housing and vehicle benefits.

Mr Speaker,

Major changes are made in this budget to the tax regime for gas, oil and mining. In effect these changes should assist the development of the PNG Gas to Queensland Project, which is now expected to proceed to front-end engineering and design by the end of the year. The changes should also encourage new mining and petroleum exploration and development.

- A general framework to guarantee fiscal stability is proposed, with the term based on the financing period.
- Incentives are proposed for marginal projects, through lower corporate tax rates and phasing out of the mining levy.
- Incentives are proposed for exploration through more liberal allowances.
- Revenue to the State from profitable projects will be higher and payable earlier through a revised Additional Profits Tax.
- Loopholes are being closed with the removal of opportunities for discretion and project-specific provisions and regimes.
- Resources tax administration is also being improved.

Mr Speaker,

To speed the delivery of services to rural areas, the Infrastructure Tax Credit Scheme is being extended. This will allow spending on maintenance as well as creation of infrastructure, and the participation of other sectors in the scheme.

The first new sector will be primary industry, on a selective basis. However, the scheme will be extended to other sectors once guidelines and administrative systems are developed by the Department of National Planning and Monitoring, who will now be responsible for the scheme. At the same time the amount of tax credit available will be restored to its original level - 0.75 per cent of assessable income.

Excise taxation is being reformed. Fixed excise charges will be levied on specific quantities of products. For example alcohol will attract a specific rate for each litre of pure alcohol, so that drinks with higher alcohol content should attract higher excise duties.

Specific rates for alcohol and tobacco products will be increased automatically by 2.5 per cent every six months, and a new clearance system will be introduced to prevent abuse.

The Taxation Review is the first comprehensive review and rationalisation of the tax system. What will be required in the future will be fine-tuning of the system and of specific regimes. The head of the Review, Sir Nagora Bogan, has been asked to assist the Internal Revenue Commission in implementing the Taxation Review recommendations, especially with regard to the strengthening of the tax administration.

Mr Speaker, total revenue and grants in 2001 are estimated at 3223.3 million kina, an increase of 6 per cent over 2000.

Domestic revenue is projected to increase by 7.5 per cent. Grants, mainly project grants from Australia, are estimated to remain unchanged at around 550 million kina.

There are no revenue measures proposed in the 2001 Budget. The Taxation Review recommendations are revenue-neutral. Therefore the increase in projected revenue is the result of the combined effect of a projected improvement in economic activity and strengthening of the tax administration.

Mr Speaker, total outlays in 2001 are appropriated at 3968.7 million kina, compared with 3774.4 million kina in 2000, an increase of 5.1 per cent.

1006.4 million kina, or 25.4 per cent of the total appropriation are debt-service payments. Of this, 267.9 million kina will be used to amortise domestic debt, in line with our strategy of reducing debt and easing the burden of future debt-service payments.

As I have said repeatedly from the day I was elected Prime Minister, *all net proceeds from privatisation will be used to retire debt*. This will save the huge interest bill, budgeted at 410.1 million kina in 2001.

Of the remaining 2962.3 million kina, 1051.1 million kina, or 35.5 per cent, is appropriated for development expenditure, the highest share ever in the 25-year history of our nation.

The Public Investment Program (PIP), or Development Budget, is 15.1 per cent higher than it was in 2000, and 33.7 per cent higher than in 1999.

Even more important than the overall growth in development budget expenditure, the level of domestic resources from our own revenue for the PIP was increased from 290.6 million kina to 390.8 million kina, or by 34.5 per cent.

A key initiative in the 2001 PIP is the Development Charter Program, which has been allocated 109 million kina and will significantly improve the delivery of basic services. The Program will implement the commitments entered into by the National Government with the Provinces under the National Charter on Reconstruction and Development.

This Government is fulfilling its promise to the people, to do all it can, within its financial capacity, to improve basic services and fund them properly.

Of special significance in the 2001 Development Budget is the allocation of 320 million kina to the infrastructure sector, 193.3 million kina of which is for maintenance.

The allocation to Members' funds is 143.5 million kina, of which 89 million kina is for the Rural Development Fund, and 54.5 million kina accrues to the provincial and district support grants.

In addition, Members will be entitled to use the balance of the Rural Development Funds not utilised in 2000, and placed in trust accounts.

The provinces are allocated 70.2 million kina of the PIP, of which 20.9 million kina is for Bougainville.

Mr Speaker, the Recurrent Budget, excluding debt service payments, is 1903 million kina, an increase of 5.9 per cent over 2000. Of this total 584.7 million kina, or 30.7 per cent, is appropriated to the provinces; 142 million kina, or 7.5 per cent, to Statutory Authorities; 639.8 million kina, or 33.6 per cent for the priority areas of Health, Education, Law and Order, Agriculture, Infrastructure and Revenue Raising, and 536.5 million kina, or 28.2 per cent, for all the other departments.

Of the total recurrent appropriation, excluding debt service payments and transfers to Statutory Authorities of 1761 million kina, 915.9 million kina, or 52 per cent is Personal Emoluments, and the remaining 845.1 million kina is Goods and Services.

This year public servants had their salaries increased by 5 per cent. Next year a further increase of about 8 per cent is provided for.

The increase in 2001 will be differential: teachers for example will receive 9 per cent, of which 7 per cent is for 2001 and 2 per cent a lump sum payment to complement the 5 per cent paid in 2000.

The increase in salaries and wages together with the tax breaks provided in the budget will restore some purchasing power to the incomes of working men and women.

Mr Speaker, Honourable Colleagues and People of Papua New Guinea,

In 2000, the Government took significant steps to re-introduce a sound policy process, one that recognises the important partnership between us as political leaders, the public service, civil society and multilateral and bilateral donors.

My Government is grateful to the financial institutions, the donors and the friendly governments for the resources they have committed in support of our policies.

The 2001 Budget sets the path for reconstruction, by capturing and building on the progress made through the successful implementation of the 2000 Budget. Important reforms are being implemented and resources are being redirected to our priority areas of health, education, infrastructure, primary industry and law and order.

May I conclude by thanking Honourable Members for their support for the economic recovery and structural reform policies that have been adopted. These policies halted our march over the edge of the abyss.

We all deserve credit for the substantial progress that has been made in the last sixteen months. That progress has not come by accident, but very much by design. I am confident that the passing of the 2001 Budget will provide accelerated momentum to this progress.

Mr Speaker, I commend the 2001 Budget to the House.