PNG: Fiscal Policy at a Crossroads

KUM HWA OH
YONGZHENG YANG

ASIA PACIFIC DEPARTMENT
INTERNATIONAL MONETARY FUND

PNG UPDATE
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I. Fiscal Performance during 2002-11

II. Changing Fiscal Policy: MTFS 2013-17

III. Prospects for 2015-19 and Long-Term Fiscal Sustainability

IV. Summary and Policy Implications
The government debt fell from 74 percent of GDP in 2002 to 22 percent of GDP in 2011.

The achievement was remarkable and compares well with Asian economies.
Successful fiscal consolidation: political commitment

- Fiscal consolidation was guided by two MTFSs.
  - MTFS 2002-07:
    - Targeting a balanced budget;
    - Achieved in 2004
  - MTFS 2008-12: Capping non-mineral fiscal deficit at 8% of GDP:
    - Mineral revenue ≤ 4% of GDP;
    - Trust accounts ≤ 4% of GDP;
    - Additional mineral revenue: 30% for debt reduction; 70% for public investment
Successful fiscal consolidation: outcome

- Strong implementation.

**Non-Resource Budget Deficit**

(In percent of GDP)

![Graph showing non-resource budget deficit/GDP from 2000 to 2012 with an 8% ceiling. The graph indicates a significant reduction in deficit over time, with a notable dip in 2008.]
Successful fiscal consolidation: good luck

- Upward trends in resource prices.

**Resource Prices**

1/ The prices are indexed by adjusting year 2000 to 100.
• Non-resource primary balance (NRPB) in 2012-2014 has been significantly lower (deficit higher) than the average of the past decade.
- Fiscal deficit: 8.5% of GDP in 2013; 8.3% of GDP (projected) in 2014.
- Central government debt rebounded to around 34% of GDP in 2013; expected to exceed 35% of GDP in 2014.
Competing fiscal frameworks

Incremental Consumption from a Resource Windfall

Resource windfall

Bird-in-hand rule
Permanent Income (PIH) rule
Optimal frontloading of domestic investment
Fiscal framework for PNG: considerations

- Resource horizon is highly uncertain but finite;
- Social and physical capital is scarce; so some frontloading is desirable, but should not cause instability;
- In this environment, priority should be given to macroeconomic stability, high-quality development, and inter-generational sharing of wealth;
- Limited absorption capacity must be a consideration.
Resource revenue projections

[Graph showing resource revenue projections for PNG LNG and Other resource revenue in both nominal and real terms from 2002 to 2048.]
Assumptions for PIH exercise: an illustration

- NRGDP growth rate: 4.5%
- Inflation: 5.5%
- Population growth: 2.5%
- Resource revenue up to 2018: based on WEO price projections and Budget 2014 projections of export volumes.
- Resource revenue from 2019 onward: LNG revenue from Budget 2013. Other resource revenue fixed at 2018 level in real term.
Sustainable fiscal balance under PIH

Non-Resource Primary Balance (NRPB) (In percent of NRGDP, constant in real term)
Baseline (MTFS) for 2015-19

- Fiscal deficit declines over time (sharply in 2015; partially due to LNG-boosted GDP)
- Debt-to-GDP ratio remains above 30% of GDP even after 2015.
Three scenarios for 2015-19: Non-resource primary balance

Non-Resource Primary Balance

(In percent of non-resource GDP)

Source: IMF staff calculations.
Three scenarios for 2015-19: overall balance

Overall Balance

(In percent of GDP)

Baseline (MTFS)
Alternative
Current fiscal stance

Source: IMF staff calculations.
Three scenarios for 2015-19: government debt

Government debt

(In percent of GDP)

Source: IMF staff calculations.
Summary and policy implications

- Major achievements in the past underpinned by strong commitment to fiscal and macroeconomic stability, helped by rising commodity prices.

- MTFS 2012-17 is heading in the right direction, but fiscal consolidation may not be fast enough to meet government debt target given large fiscal expansions in 2013-14 and weaker commodity prices.

- Critical choices to be made:
  - Current (2013-14) fiscal stance not sustainable.
  - Sustainable policy requires steadfast fiscal consolidation over the medium term.
  - Focus on spending quality within the resource envelope.