Transforming a resource rich economy: reflections on some policies in Papua New Guinea

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CPA PNG LAE ANNUAL CONFERENCE 2017
Lae, Morobe Province
24 August 2017

“The current state of PNG economy, its impact on business and the accountant’s role.”

The views I express today are my own, not necessarily those of my colleagues at the PNG National Research Institute.
PNG is resource rich...

- PNG has abundant renewable and non-renewable natural resources
  - Minerals (gold, copper, nickel, etc)
  - Petroleum (Oil, gas)
  - Forestry
  - Fisheries

- PNG also has human capital resources
  - Though not currently well developed
  - But has potential to increase skilled workforce
After 2017 Elections…

- No new policies, but focus on priority “unfinished agenda”

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Government’s wish…

- To provide abundant opportunities for Papua New Guineans individually and collectively as a nation
  - To deliver key projects and services to the people

- No. 1 Priority: Not just economic growth, but
  - Inclusive growth; sustained economic growth
    - Provide increased incomes for households
      - To lift themselves out of poverty
      - Gain access to education and healthcare
Government’s plan...

- “To revitalise the economy, focussing on **generating more revenue**...”
  - But also...
    - ✓ cutting down public expenditure
    - ✓ managing debt levels

- To **generate more revenue**
  - Key policy areas focussing on the people
    - Wages
    - Taxation
    - Business, especially SMEs
Wages

- Most people work in informal sector
  - Self-employed; or Contributing family workers
  - More than half are women

- The few working in formal sector
  - May be considered “working poor”
  - They earn minimum wages – K140/- a week
    - Wage barely sufficient for a living
    - Even for a family without wantoks
The concept of living wage

- Individuals whose income does not support living conditions are considered being “poor”
- Families whose income is less than standard household budget should also be considered “poor”
- Policy should target these “poor” individuals and families
  - To strengthen their economic resilience
- Need to adopt the concept of living wage
  - To address inequality issues
  - To improve peoples’ living standards
Minimum wage policy

- There is a need to revisit minimum wage policy
- Should move away from cost aspect of wages
  - Small increase in minimum wage
    - Unlikely to be very expensive to businesses
    - Likely to be very small compared to other costs
- Should move towards more pluralistic approach
  - Emphasise on equity and fairness
  - Everyone benefit from country’s resource wealth
Taxation policy

- Because of wages are sticky upwards,
  - Government want to lower personal income taxes
  - But only when revenue levels increase (per Alotau Accord II)
    - What level of revenue will trigger change?

Personal income tax
- Not the most important means of raising revenue
- Especially in resource rich countries
- Except in PNG – Personal income tax rates so high
  - PNG tend to rely on personal income tax
    - Account for 10% of GDP
    - More than half non-trade tax revenue collected by IRC
Revenue trends...

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<th>2015 (Actual)</th>
<th>2016 (Actual)</th>
<th>2017 (MYEFO)</th>
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<tr>
<td>K 'Million</td>
<td>%</td>
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<tr>
<td>Personal income tax</td>
<td>3,037.1 49.9</td>
<td>2,844.3 52.9</td>
<td>3,035.7 54.1</td>
</tr>
<tr>
<td>Company tax</td>
<td>2,374.8 39.0</td>
<td>2,093.8 38.9</td>
<td>2,143.6 38.2</td>
</tr>
<tr>
<td>Mining &amp; petroleum tax</td>
<td>390.0 6.4</td>
<td>184.0 3.4</td>
<td>154.2 2.7</td>
</tr>
<tr>
<td>Royalties &amp; management tax</td>
<td>51.3 0.8</td>
<td>26.6 0.5</td>
<td>27.3 0.5</td>
</tr>
<tr>
<td>Dividend withholding tax</td>
<td>168.9 2.8</td>
<td>17.7 0.3</td>
<td>19.2 0.3</td>
</tr>
<tr>
<td>Interest withholding tax</td>
<td>66.0 1.1</td>
<td>132.6 2.5</td>
<td>146.3 2.6</td>
</tr>
<tr>
<td>Tax related court fines</td>
<td>- 0.0</td>
<td>78.7 1.5</td>
<td>85.0 1.5</td>
</tr>
<tr>
<td>Sundry IRC receipts</td>
<td>0.6 0.0</td>
<td>0.5 0.0</td>
<td>0.5 0.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6,088.7 100.0</td>
<td>5,378.2 100.0</td>
<td>5,611.8 100.0</td>
</tr>
</tbody>
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What will be the source of the revenue

Source: Treasury, 2017 Mid Year Economic and Fiscal Outlook
Trend in revenue by tax type, %

- Personal income tax
- Company tax
- Mining & petroleum tax
- Royalties & management tax
- Dividend withholding tax
- Interest withholding tax
- Tax related court fines
- Sundry IRC receipts

Comparison years: 2015, 2016, 2017
What do you see?

Focus on generating more revenue:
- Increasing share of personal income tax – target?
- Decreasing share of mining, oil and gas taxes
- Decreasing share of corporate income tax
- Increase in share of interest withholding tax

Big share of personal income tax
- Not because salaries and wages are high
- Not because level of formal employment is high
- But because personal income tax rates are too high
The case for lowering personal income tax

- Marginal tax rates last adjusted in 2008
- Tax free threshold last increased to K10,000/- in 2001
- High cost of living, especially in major cities
- Individuals have very little to save and invest
  - Yet creating and growing SMEs is also a priority
- The question is:
  - How will personal income tax be lowered when it is increasingly becoming the main source of revenue?
An alternative to increasing PIT revenue

- Remove unnecessary tax preferences
  - Particularly those currently given to the highly profitable mining, oil and gas operators

- In the recent past
  - GDP growth was in part driven by gas production
  - Increase in Kina prices of major export commodities
    - But how much was from LNG exports?

- In future
  - Negative contribution of oil & gas extraction to GDP growth
    - Alarm bell for early diversification of the economy
    - To non-mineral sector – agriculture, tourism, forestry, manufacturing, etc
Will oil and gas extraction drag PNG’s economy?

Source: Department of Treasury
Diversification of the economy is a good idea

But diversify to small, medium or large businesses?

All segments are important

But the more important segment is SMEs
- Can provide employment for a large segment of the population
- Create wealth, narrow income gap between men and women
- 31-38% of SMEs in emerging markets are owned by women

Hence, Govt proposing to lend K100 million to SMEs

Is this good for the economy?
Support for SMEs…

✓ SMEs face special problems worldwide
✓ Access to finances – most cited in surveys/interviews
✓ Need government support
  • Even in developed countries governments provide assistance to SMEs
✓ But what is PNG’s past experience?
  ✓ The Agricultural Development Bank collapsed as loans never repaid
  ✓ The Co-operative Societies Support Grant unaccounted for
  ✓ These government lending schemes collapsed
    • Accountability was lacking
    • Did not follow strict “Good governance” and “Ethics” requirements
✓ But there is some ray of hope
  • A Bill establishing Independent Commission Against Corruption is underway...
SMEs need support, not necessarily financial

✓ Recent research suggest that access to finance is *not* a major binding constraint
  ✓ Problem could be bad bank-customer relationships

✓ Commercial banks are ready to lend to SMEs
  ✓ Problem is potential borrowers lack required collateral
  ✓ Govt could help borrowers;
    ✓ Obtain secure titles to collateral, e.g. land title deeds

✓ Credit guarantee schemes will be successful and sustainable
  ✓ If entrepreneurs have financial capacity and willingness to repay loans
  ✓ If there is a business-sense culture, enabling people to create income earning opportunities for themselves – to be able to repay loans
Concluding comments

PNG has been relatively successful in its growth
But has not done well in achieving shared prosperity
- Unemployment, poverty, deprivation
- Low wages; high personal income taxes

PNG has the potential to do better
Taking advantage of its resources
- Commensurate revenue contribution of resource extraction projects
- Not relying on personal income tax revenue to transform the economy
Better diversification of the economy

Government can assume a major role in the economy
But using markets to have share in major projects
Private sector playing the more important role – doing business
Thank You

TENK YU