PAPUA NEW GUINEA

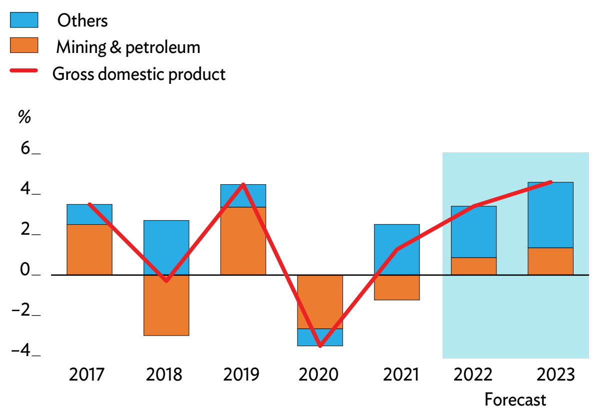
Growth returned in 2021 but was dampened by two COVID-19 surges worsened by a very low vaccination rate. Some relief came from strong commodity prices and fiscal stimulus sustained by development partners. Elections in 2022 will occasion additional spending, and higher mining output from the second half should accelerate growth. Rising commodity prices in 2022 will buoy the current account and inflation, both subsiding somewhat in 2023. An expanded revenue base would support economic recovery.

Economic performance

Following contraction in 2020, the economy returned to growth in 2021 but only at an estimated 1.3% (Figure 3.34.1). Two large surges of COVID-19 during the year significantly restrained economic recovery. The first was from February to July, and the second, attributed to the Delta variant of COVID-19, ran from September until late December. As of early March 2022, 41,533 cases of COVID-19 and 638 deaths had been reported. While no national lockdowns were imposed during the year, some regional lockdowns affected provinces whose health services had become overwhelmed. Travel restrictions were imposed, and for much of the year incoming travelers were required to quarantine for 2 weeks. The first vaccines were administered in March 2021, but the rollout was hampered by a weak delivery system and prevalent reluctance to be inoculated, such that less than 3% of the population of Papua New Guinea (PNG) was fully vaccinated by the end of 2021.

Figure 3.34.1 Gross domestic product growth

Growth was dampened by two surges of COVID-19, but is expected to accelerate to the forecast horizon.



Source: Asian Development Bank estimates using data from Papua New Guinea National Statistical Office.

Having contracted by 21.1% in 2020, mining and quarrying contracted further by an estimated 12.5% in 2021. Porgera, the second-largest gold mine in the country, remained shut for all of 2021, having closed in April 2020 after its mining license was not renewed. Other big mines reduced production in the face of operational challenges, including COVID-19, among them the Ok Tedi gold and copper mine and the Lihir gold mine. Lihir is the largest gold mine in PNG, contributing in 2019 about 40% of the country's gold production, but saw gold output fall by 14% from 2020 to 2021. Petroleum was broadly flat, with liquefied natural gas output in 2021 little changed from 2020 and oil production only slightly higher.

Agriculture, forestry, and fisheries expanded by an estimated 3.7% in 2021, largely reflecting recovery from a low base in 2020, when output was hampered by lockdowns and trade bottlenecks. Increased

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production of palm oil, cocoa, and coffee was stimulated by rising global commodity prices and the resolution of trade bottlenecks. Log and fish production changed little from 2020.

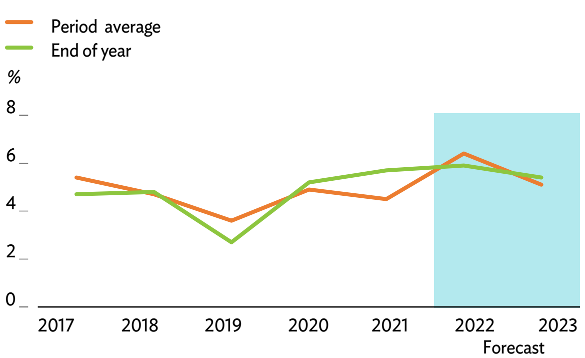
Growth in the rest of the economy was generally weak. Having contracted significantly in 2020, transport and storage services and accommodation and food services recovered only marginally in 2021 as COVID-19 continued to affect business travel and tourism and deter investment. However, construction, which had been hampered in 2020 by lockdowns and travel restrictions, picked up in 2021 as government capital expenditure rose from the equivalent of 8.1% of GDP in 2020 to 8.5% in 2021.

The fiscal deficit in 2021 equaled 7.1% of GDP, according to a 2022 national budget document released by the Department of Treasury in November 2022. The final deficit may exceed this amount, however, considering a tendency to underbudget in certain areas, including public sector wages.

Inflation averaged 4.5% in 2021 but stood at 5.7% year on year in December 2021 (Figure 3.34.2). Transportation costs increased by 7.7% in the year to December, and education costs jumped by 20.0% as the government introduced tuition fees in public schools. Food prices increased by 5.2%, mostly reflecting higher prices for edible oils, led by cooking oil, which jumped by 35.6%. By contrast, rent slipped by 0.6% and, with greater competition in the marketplace because of new entrants, communication costs fell by 2.5%.

Figure 3.34.2 Inflation

Inflation remained high, driven by rising commodity prices.

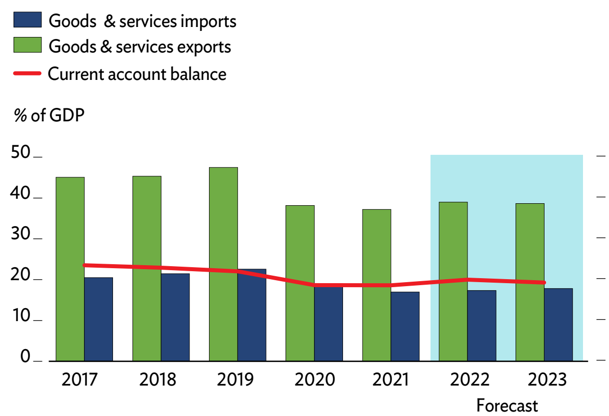


Source: Asian Development Bank estimates using data from Papua New Guinea National Statistical Office.

The current account surplus expanded from the equivalent of 20.2% of GDP in 2020 to 22.0% in 2021 (Figure 3.34.3). Exports saw gains with higher prices for palm oil, copper, and oil, which offset weaker mineral output, while imports decreased, reflecting weak investment.

Figure 3.34.3 Current account balance

Exports and imports alike fell in 2021 as percentages of GDP, but the large current account surplus was little changed.



GDP = gross domestic product.

Sources: Bank of Papua New Guinea; Asian Development Bank estimates.

Economic prospects

Growth is expected to accelerate steadily to 3.4% in 2022 and 4.6% in 2023 as activity in mineral extraction picks up and more normal global economic conditions return (Table 3.34.1). The Porgera gold mine, which contributed about 28% of the country's annual gold production before it closed, is expected to reopen in the second half of 2022 and ramp up production only later. Its effect on GDP will therefore be greater in 2023 than in 2022. Papua LNG, a long-awaited liquefied natural gas project, is expected to proceed to its front-end engineering and design phase in the middle of 2022, but project expenditure within PNG during this first phase may not be large. A final investment decision should be made in the second half of 2023, when construction is expected to commence. Several other large resource projects are on the horizon. The P'nyang gas field project is a multibillion-dollar investment, as is the Wafi Golpu gold and copper mine, but its timing remains uncertain.

From the outset of 2022, however, the economy has been weighed down by the Omicron variant of

COVID-19, which appeared in PNG in January. If experience elsewhere is a guide, its effects should dissipate fairly quickly, allowing a return to more normal conditions from sometime in the second quarter. In February, the PNG authorities ended quarantine requirements for incoming travelers who are fully vaccinated.

Table 3.34.1 Selected economic indicators, %

Growth is projected to gradually accelerate.

	2020	2021	2022	2023
GDP growth	–3.5	1.3	3.4	4.6
Inflation	4.9	4.5	6.4	5.1
CAB/GDP	20.2	22.0	26.5	22.1

CAB = current account balance, GDP = gross domestic product.
Source: Asian Development Bank estimates.

Uptake of COVID-19 vaccines in PNG is unlikely to improve significantly in 2022, so the vast majority of the population will remain unvaccinated. These conditions could discourage overseas arrivals, but commercial investors are unlikely to be deterred as they are already used to dealing with many challenges in PNG.

National and local government elections are scheduled for the middle of 2022. Significant expenditure will accompany the election period as spending is ramped up in provinces to improve services and infrastructure and as aspiring candidates fork out on rallies and other events to win votes. The government has pledged an additional K600 million for the election to cover security arrangements, logistics, and polling. Providers of accommodation and food services and of transportation services are expected to benefit.

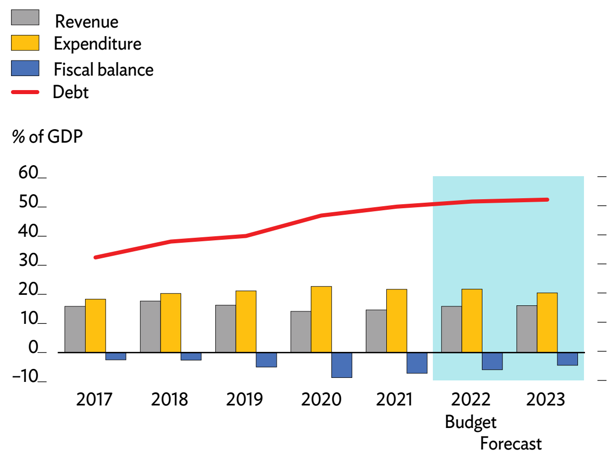
Inflation is expected to gather pace in 2022 as the Russian invasion of Ukraine pushes up commodity prices and in particular oil prices. Inflation should moderate in 2023 as commodity prices cool and global economic conditions normalize.

The current account surplus is forecast to widen to the equivalent of 26.5% of GDP in 2022, driven up by rising commodity prices and reopening of the Porgera mine. Then it is seen narrowing somewhat to 22.1% in 2023 as import volume picks up to supply increased investment and as, geopolitical events permitting, commodity prices cool.

The 2022 national budget forecasts a fiscal deficit equal to 5.9% of GDP in 2022 and 4.4% in 2023 (Figure 3.34.4). Raising sufficient revenue and other financing to execute the budget in 2022 will be a challenge. Revenue should, however, find support in higher oil and gas prices, particularly taxes and dividends paid by the PNG LNG project. The Department of Treasury forecasts that accumulated national debt will rise to equal 51.9% of GDP in 2022 and 52.5% in 2023.

Figure 3.34.4 Fiscal balance

Debt levels should stabilize if the government can meet its fiscal consolidation targets.



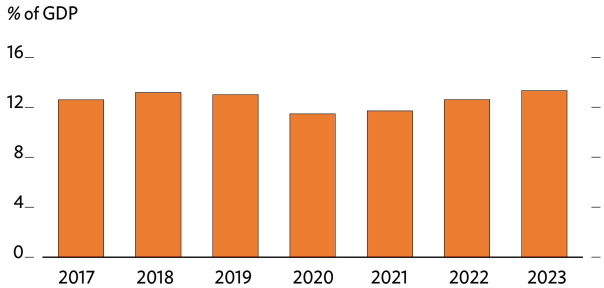
GDP = gross domestic product.
Source: Papua New Guinea Department of Treasury.

Policy challenge— expanding the revenue base to support economic recovery

The ratio of tax to GDP in PNG has followed a declining trend, falling from 18.6% in 2013 to 13.0% in 2019, before the pandemic, and then further to 11.5% in 2020 and 11.7% in 2021 (Figure 3.34.5). These ratios are well below norms in Asia and the Pacific, where the average ratio in 2019 was 14.6% in Southeast Asia, 14.9% in South Asia, and 22.9% in the Pacific. Compared with other low-income, resource-rich developing countries in 2019, however—11.5% in Gabon, 13.8% in Brazil, 9.4% in Angola, and 9.3% in Equatorial Guinea—the PNG ratio is fairly typical.

Figure 3.34.5 Ratio of tax revenue to GDP

The ratio of tax revenue to GDP is lower in PNG than in most other countries in Asia and the Pacific.



GDP = gross domestic product.
Source: Papua New Guinea Department of Treasury.

The PNG tax take from mineral and petroleum companies is notably low. Only 7.0% of all tax revenue in 2019, equal to 0.6% of GDP, came from mining and petroleum companies in the form of corporate taxes. This had fallen to 4.8% by 2021.

Aside from tax revenue, PNG benefits from nontax revenue, including income from state-owned enterprises, authorities, and investments, that averaged the equivalent of 1.4% of GDP from 2017 to 2021. It also receives grants, which annually averaged 2.0% of GDP over the same period.

A taxation review commissioned by the government and released in 2015 identified core taxation challenges for PNG: (i) too much reliance on personal income tax, (ii) too narrow a tax base and resulting reliance on high rates for corporate and personal income tax, (iii) outdated and unclear tax legislation, (iv) overused tax discretionary incentives, (v) overly generous use of stability contracts in resource development projects, and (v) a tax administration system ill-suited for business growth and development.

In response to these challenges, the authorities developed with support from the International Monetary Fund the Medium-Term Revenue Strategy, 2018–2022. It targeted three strategic reforms: (i) amend tax policy to broaden the tax base and address distortions, (ii) modernize and simplify tax legislation, and (iii) improve tax administration and compliance.

As a first step, a steering committee was established to lead the implementation of reform, starting with establishing the Revenue Policy Branch within the Department of Treasury.

To strengthen tax compliance and administration, an office for large taxpayers was created in 2018. PNG customs underwent several administrative changes to boost tax collection, notably through stiffer enforcement and a crackdown on trade in illicit goods. The Customs Act, 1951 was amended in 2020 to increase penalties for traders evading tax.

The Tax Administration Act, 2017 was introduced to clarify tax laws and require taxpayers to apply for a tax identification number. Further, significant revision to the Income Tax Act intends to simplify tax compliance, in part by introducing a simple tax for small businesses.

It is important for PNG to sustain momentum toward tax system reform. A new medium-term revenue strategy, 2023–2027 is due for development to guide reform. Strong leadership is needed, both political and in the bureaucracy, to ensure that sufficient attention and resources are directed toward its development and implementation. Continued support from international partners is also essential.

Revenue collection can be improved and sustained by adopting international best practices and tax standards, including doing away with discretionary exemptions and tax concessions; expanding revenue agencies' investment in technology; and implementing effective revenue legislation and policy.

Finally, PNG must continue to consider carefully how best to tax mineral and petroleum companies, and it should seek the best international advice available.