Papua New Guinea slashes budget to provide corporate tax breaks

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After intensive discussions with Australia, the World Bank and the IMF, the Papua New Guinea government handed down a budget last week that granted huge tax exemptions to investors in mining projects, while imposing drastic spending cuts on the public service and education.

For the petroleum sector, the budget is a bonanza, slashing the present sector-specific corporate tax rate of 45 percent by a third to 30 percent. It also offers a string of other financial benefits to all mining companies—including the abolition of additional taxes after a project achieves a set rate of return, as well as additional deductions for exploration and depreciation.

The changes are aimed in particular at securing the construction of a $6 billion pipeline from gas fields in the PNG highlands to the northern Australian state of Queensland. Prime Minister Michael Somare is currently in Australia to push the project, which his government regards as crucial to salvaging the floundering PNG economy. Additional financial incentives include a reduction in stamp duty and the removal of customs duty on most materials used in the pipeline's construction.

Somare is addressing a PNG investment conference in Sydney this week in a desperate bid to attract further mining investment. In 2000, mining and petroleum accounted for 77 percent of exports and about 21 percent of the country's GDP. But over the past five years, exploration has virtually come to an end. Within 10 years, without the opening up of new projects, only the Lihir gold mine will still be functioning.

To fund the huge concessions to mining corporations, the PNG budget makes deep inroads into social spending, puts further privatisations on the agenda and raises the general corporate tax rate from 25 percent to 30 percent.

Public sector wages and recruitment will be frozen for 2003. An expenditure review has been established to save a further K84 million [$US24 million] by cutting government departments and agencies. The government will scrap its free education policy and cut education funding from K135 million to just K60 million. As a result, many more parents will be unable to afford to send their children to school.

Somare has restarted the extensive program of privatisation, begun by the previous government headed by Mekere Morauta. According to the budget papers, the government plans to raise K200 million by selling Telecom and the Harbours Board in 2003.

These measures come on top of a supplementary 2002 budget, handed down in August by Treasurer Bart Philemon, which contained cutbacks totalling K376.5 million or the equivalent of 10 percent of the budget.

Somare won national elections in July by exploiting widespread hostility to the economic restructuring policies of Morauta. He commented in August that privatisation had "destroyed the PDM" [Morauta's party] but the new government has since come under strong international pressure to proceed.

The budget's basic framework was set out for the Somare government at an Australia-Papua New Guinea Ministerial Forum held on 14 November, attended by six Australian ministers headed by Foreign Minister Alexander Downer, as well as representatives from the IMF and World Bank.

Faced with a major financial crisis, Somare requested a new loan of $20 million from Australia and an extension for a $100 million repayment due next year. Downer bluntly turned down the requests and insisted that the PNG government implement the Structural Adjustment Program developed by Morauta at the behest of the IMF. "We will need to see some runs on the board before we make any further commitments," he contemptuously declared.

The economy is already mired in recession—the GDP contracted by 3.5 percent in 2001 and is expected to decline by a further 2.5 percent in 2002. The IMF has recently described the public debt, which exceeds 70 percent of GDP, as unsustainable. More than a quarter of the budget is allocated to paying loans. Since Somare came to office in August, the PNG currency, the kina, has lost a third of its value and has reached all time lows against the US dollar. Last month, Standard & Poors downgraded the country's credit rating to negative.

As soon as he took office, Somare pledged to continue Morauta's austerity measures. The Australian government, however, which had strongly backed Morauta, a former merchant banker and head of the PNG's reserve bank, viewed Somare with a degree of scepticism. The ministerial meeting in mid-November was to ensure that Somare proceeded with the Structural Adjustment Program.

The program drawn up by Morauta in 1999 includes the sell-off of most of the government assets and mass sackings of public servants. To fully comply with the program, the Somare government will have to cut the public sector by between a fifth and a third, and carry out thousands of further retrenchments. Already, however, the impact on the country's limited social services has been severe.

Each of the 20 provinces operates with administrations that are hopelessly undermanned. Commenting on the rundown of social services, the Melbourne-based *Age* pointed out: "Infrastructure has been in a state of decay for much of the 1990s. There are almost no funds for maintenance. In the Gulf district, 42 per cent of primary teaching posts are vacant." Eleven high schools in the Western Highlands Province have closed due to a lack of funds.

Retrenchments in the public sector have contributed to the country's high levels of unemployment, which is estimated at 80 percent in urban centres. The falling value of the kina has fuelled sharp rises in prices. In the first two weeks of November the cost of rice rose by 25 percent Almost one in three people are undernourished. The poorest 25 percent of the population eat less than 2,000 calories a day and 62 percent of children are growing up stunted.

Lack of money for health services will only compound the country's emerging HIV/AIDS epidemic, which appears to be following African patterns. According to a World Health Organisation estimate, 22,000 people are currently infected. A recent survey in Port Moresby showed a 1 percent infection rate for women giving birth during the last six months.

Canberra's insistence that Somare slash spending to fund financial incentives for giant international mining and oil corporations will worsen what is already a severe social disaster in the former Australian colony.