Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 3-Aug-2018 | Report No: 129960

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Independent State of Papua New Guinea	P165717	First Economic and Fiscal Resilience Development Policy Operation	
Region	**Estimated Board Date**	**Practice Area (Lead)(s)**	**Financing Instrument**
East Asia Pacific	September 20, 2018	Macroeconomics, Trade and Investment; Governance	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Independent State of Papua New Guinea	Department of Treasury		

Proposed Development Objective(s)

The Program Development Objective is to:
* Strengthen fiscal management and revenue performance;
* Strengthen key building blocks for public financial management and financial inclusion.

Financing (in US$, Millions)

SUMMARY

Total Financing	150

DETAILS

Source:	
IDA	150
Co-financing	-

Decision

The Decision from the Decision Meeting was to authorize the team to appraise and negotiate the proposed operation.

B. Introduction and Context

Country Context

PNG is highly abundant in natural resources and the extractive resource sector has risen to almost define the PNG economy today. Discoveries of gold and copper resources in the 1970s, followed by natural gas and crude oil in the 1980s, saw the extractive sector increase from a negligible share of the economy around the time of independence to about 26 percent of GDP and 81 percent of exports today. The sector is an important source of economic growth, foreign direct investment and foreign exchange but has limited linkages with the rest of the economy and is a significant source of macroeconomic challenges when global commodity prices decline. In particular, the sensitivity of the country's GDP growth and fiscal performance to developments in global commodities prices has been the basis of periodic boom and bust economic cycles. This pattern is compounded by the fact that the non-extractive resource sector (agriculture, forestry and fishing), which represents 20 percent of GDP and 19 percent of total exports, is also sensitive to global commodity price swings and natural hazard shocks. In the absence of strong macroeconomic institutions, this volatility has been frequently transferred to the domestic economy, placing considerable stress on fiscal outcomes, public spending, service provision and governing institutions. In any case, the significant benefits that the extractive sector has delivered have not filtered through to many in PNG and, despite several decades of major extraction activities, long-term growth is relatively low (due to its volatility) and the country may arguably have limited development results to show for it. Recent fiscal consolidation and reforms, and discussions with the IMF on actions to strengthen the monetary and exchange rate policy framework, underpin the assessment that the macroeconomic policy framework is adequate for the purpose of the proposed operation. Going forward, the government is working to build on existing reform progress in the areas of fiscal management, revenue mobilization, public financial management (PFM), and financial inclusion – particularly for women.

Relationship to CPF

The proposed DPO series is aligned with the World Bank Group's overall engagement with PNG, as laid out in the CPS FY2013-FY2018. The third pillar of the CPS is 'Increasingly prudent management of revenues and benefits', with macroeconomic management one of the key components of that pillar. The two pillars of the DPO are closely aligned with this CPS component, and are expected to support poverty reduction and shared prosperity through improved medium-term fiscal stability, expenditure sustainability and budget execution – critical foundations for the delivery of public services of most importance to the poor. The first pillar of the CPS is 'Increased and more gender equitable access to inclusive physical and financial infrastructure', with the financial sector one of the key components of that pillar. The measures to increase financial inclusion – especially for women – under the second pillar of the DPO are closely aligned with this CPS component, and are expected to support poverty reduction and shared prosperity through improving the policy environment for women's access to finance. A new Country Partnership Framework (CPF) covering the period FY2019-FY2023 is currently under preparation. The DPO series is complemented by a set of other World Bank Group engagements, including in the areas of rural service delivery, urban youth employment, transport, agriculture, water and sanitation, communications, health, energy, extractive industries, tourism, finance, tax policy and administration, private sector development, and women's participation in the private sector.

C. Proposed Development Objective(s)

The Program Development Objective (PDO) is to: (i) strengthen fiscal management and revenue performance; and (ii) strengthen key building blocks for public financial management and financial inclusion.

Key Results

The main results expected from the series are: (i) improved fiscal stability and sustainability; (ii) better accountability and transparency in the use of public funds; and (iii) increased financial inclusion – particularly for women.

D. Program Description

Contributing to the first PDO on fiscal management and revenue performance, the proposed operation supports the adoption of the non-resource primary balance as a share of non-resource GDP as a fiscal anchor, measures to improve tax administration and compliance (including the approval of the new Tax Administration Act, making Tax Identification Numbers mandatory, and the structure of a new Large Taxpayer Office), the preparation and publication of a tax expenditure statement, and an increase in the excise on diesel. Indicative triggers include the adoption of an annual budget consistent with the Medium Term Fiscal Strategy, consequential amendments to existing tax legislation in preparation of the coming into force of the Tax Administration Act, and completion of a review of tax incentives. Contributing to the second PDO on public financial management and financial inclusion, the proposed operation supports the rollout of the new Integrated Financial Management System in national government departments, and the adoption of the Financial Sector Development Strategy, National Financial Inclusion Policy and Gender Equity and Social Inclusion Policy for Microfinance Institutions. Indicative triggers include bringing bank reconciliations up to date in key national government departments and statutory authorities, and the implementation of a new National Switch platform for financial transactions.

The policy actions contributing to the first PDO are directly aligned with the fiscal management and revenue mobilization components of the government's development program. The fiscal anchor and diesel excise actions also support the disaster responses and recovery objective and broader environmental protection objectives under the sustainable development and climate resilience component of the government's program. The policy actions contributing to the second PDO are directly aligned with the PFM reform and gender equality components of the government's program.

E. Implementation

Institutional and Implementation Arrangements

The Treasury is responsible for overall implementation of the proposed operation and for coordinating the monitoring and evaluation of the result indicators for the series. The Treasury has set up a high-level team at First Assistant Secretary level to monitor and evaluate the progress of the proposed operation. This team has the capacity to monitor and evaluate the results of the budget support operation. The Treasury will coordinate with the relevant government departments on the indicators for revenue, cash management and financial reporting. The Treasury will also coordinate with the Bank of PNG on financial inclusion indicators. The results indicators chosen for the operation have been selected with a view to the ready availability of data of reasonable timeliness and quality. Capacity constraints in such a small public administration affect the array, timeliness and quality of available data. Where possible, results indicators have been selected from those that already exist, rather than requiring new data to be produced, diverting scarce capacity from core data collection and analysis functions.

F. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The policy actions on establishing a medium-term fiscal anchor, strengthening revenue administration and enhancing revenue compliance, preparing a tax expenditure statement, and implementing the IFMS, are expected to have an indirect, positive effect on poverty reduction and on women. This is due to their contribution to a more stable public expenditure profile and better budget execution, both of which should support the delivery of public services. Given the strong correlation between delivery of key services and poverty, ensuring the delivery of public services will have an indirect impact on reducing poverty. Given the importance to women and children of key public services (like primary care for maternal, reproductive and child health), these reforms are expected to have particular benefits for women and children. The policy action on adopting new financial sector and financial inclusion strategies, is expected to have a direct positive impact on poverty reduction, through increasing access to finance for the poor – particularly for women. The policy action on increasing diesel taxation is expected to have a small negative impact on poverty, all else constant. Studies reveal that the impacts of diesel price increases on the poor vary across countries depending on the magnitude of the increase and country specific circumstances such as the weight of diesel in the CPI basket, the proportion of diesel consumed by the poorest quintiles, the possibility of substitution away from diesel to other fuels, and the existence and effectiveness of countervailing targeted policies and actions to mitigate the impact of higher prices on the poor. Even though the poorest quintiles in PNG are expected to have a higher dependence on diesel-based public transport, there are a number of reasons for the expected small negative impact on poverty. Firstly, the increase in the diesel tax is moderate and gradual: to align diesel excises more with petrol excises, the diesel excise will increase moderately by 13 toea (US$ 0.04) every two years until the gap between diesel and petrol excises is closed. Secondly, given that the National Statistics Office estimates diesel to account for only 0.5 percent of the CPI basket and transport (as a whole) accounts for 12 percent of the CPI basket, the share of household expenditure on diesel (as a component of transport expenditure) is expected to be relatively small.

Environment Impacts

Most of the prior actions supported under the proposed operation are not expected to have significant effects on PNG's environment, forests or natural resources. These concern the medium-term fiscal anchor, revenue administration and compliance, tax expenditure statement, IFMS, and financial sector and financial inclusion strategies, which in the team's judgement will not have significant environmental effects. The action on diesel taxation is expected to have significant positive environmental effects. Emissions from diesel combustion have been found to have severe negative local environmental impacts, significantly more so than those from petroleum. Diesel emissions include nitrogen and sulfur dioxides, and particulate matter, which are harmful to human health and have been linked to respiratory illnesses. While mitigating technologies such as particulate filters, exhaust gas recirculation and selective catalytic reduction do exist, these require maintenance and tend to be absent from older vehicles. Consequently, in a low-income country such as Papua New Guinea, where the vehicle fleet is old and poorly maintained, and where commercial diesel generators are unlikely to include newer mitigation technologies, shifting the composition of fuel use in favor of petroleum is expected to yield significant benefits for air quality and human health.

G. Risks and Mitigation

The key risks to the proposed operation come from PNG's political and governance context, macroeconomic situation, fiduciary environment, and vulnerability to natural disasters. Other significant risks arise from institutional capacity, environment and social risks, and stakeholders. Political and governance risks to the operation are accentuated by the relatively recent nature of the Bank's stronger economic policy dialogue with GoPNG. This risk is being mitigated by the selection of policy and institutional actions that the government has already made significant investments in, as well as indicated strong support for in the policy dialogue with the Bank, and the implementation support and monitoring accompanying the programmatic series. The key macroeconomic risks to the operation arise from the resource-dependency of the economy, with the risk that a downturn in commodity prices indirectly reduces activity in the non-resource economy, limiting revenue receipts from the non-resource economy and threatening the achievement of the result under the fill pillar, or that worsening foreign exchange market imbalances affect macroeconomic stability. These risks are being mitigated over the medium term by the supported actions on the fiscal framework and revenue performance, by the parallel reforms the government is undertaking to its monetary and exchange rate policies, and by the provision of budget support to moderate current fiscal constraints. The fiduciary risk of the proposed operation is rated high, due to weaknesses in public financial management and the foreign exchange control environment. This risk is being mitigated by the adoption of specific disbursement and auditing measures. PNG's vulnerability to natural disasters is another key source of risk to the operation, with budget execution and policy priorities likely to be destabilized by a major disaster, such as the 7.5 magnitude earthquake in February 2018.

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