# Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 25-Mar-2019| Report No: PIDC25467

## BASIC INFORMATION

### A. Basic Project Data

| Country | Project ID | Project Name | Parent Project ID (if any) |
|---|---|---|---|
| Papua New Guinea | P168148 | Papua New Guinea - Second Economic and Fiscal Resilience DPO (P168148) | P165717 |
| **Region** | **Estimated Board Date** | **Practice Area (Lead)** | **Financing Instrument** |
| EAST ASIA AND PACIFIC | Sep 26, 2019 | Macroeconomics, Trade and Investment | Development Policy Financing |
| **Borrower(s)** | **Implementing Agency** | | |
| The Independent State of Papua New Guinea | Department of Treasury (PNG) | | |

**Proposed Development Objective(s)**

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

**Financing (in US$, Millions)**

**SUMMARY**

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| **Total Financing** | 69.90 |

**DETAILS**

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| **Total World Bank Group Financing** | 69.90 |
| World Bank Lending | 69.90 |

Decision

The review did authorize the preparation to continue

## B. Introduction and Context

### Country Context

The proposed operation is the second in a programmatic series of development policy operations (DPOs), designed to support economic and fiscal resilience in Papua New Guinea (PNG). The programmatic DPO series specifically aims to enhance PNG's fiscal policy framework, improve revenue-mobilization policies and administration, strengthen key building blocks for public finance management, and increase financial inclusion of the population, including a better access of women to financial products and services. The policy and institutional actions supported under the DPO series cover measures that have been prioritized by the Government of PNG (GoPNG) in its Medium-Term Development Plan III 2018–2022 (MTDP III), the Medium-Term Fiscal Strategy 2018–2022 (MTFS), the Medium-Term Revenue Strategy 2018–2022 (MTRS), the Public Expenditure and Financial Accountability (PEFA) Road Map 2015–2018, and the National Financial Inclusion Policy. The proposed DPO series is aligned with the overall engagement of the World Bank (WB) with the GoPNG, as laid out in the Country Partnership Framework for the period FY19–FY23 (CPF). This DPO series is the first DPO engagement with PNG for many years, and the request for budget support from the GoPNG is an illustration of the stronger country relationship that the WB and the GoPNG have built over the past decade.

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 1/4 of GDP and 4/5 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. As the PNG economy has become increasingly concentrated in hydrocarbon-related activities since 2014, this raised its vulnerability to external shocks, including commodity-price shocks and natural disasters. To address this, the authorities have taken steps to promote greater diversification of the economy by adopting its new five-year MTDP III, focusing on inclusive and sustainable growth and envisaging higher public investment in physical infrastructure; and announcing the 2019 National Budget with a focus on supporting the implementation of MTDP III and building a broader-based economy.

### Relationship to CPF

The proposed DPO series is aligned with the World Bank Group's overall engagement with PNG, as laid out in the CPF. The first focus area of the CPF is 'improving macro and fiscal resilience', under which the first objective is strengthening fiscal management, including both macroeconomic management and public finance management (PFM). The outcome indicators for this objective are improved non-resource primary fiscal balance as a share of non-extractive GDP, increased non-resource tax revenue as a share of GDP, and improved accountability and transparency in the use of public funds through the timely submission of annual financial statements to the Auditor General's Office. Both pillars of the DPO are closely aligned with this CPF objective and its outcome indicators, and are expected to support the twin goals of 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 third focus area of the CPF is 'encouraging private sector growth and job creation in the non-resource sectors', under which the first objective is improving micro and small and medium enterprise (SME) competitiveness and access to financial services, and the third objective is deepening economic participation of women and youth. The outcome indicators for these objectives include improved financial inclusion and increased numbers of women holding transactional accounts. The second pillar of the DPO is closely aligned with these CPF objectives and outcome indicators, and is expected to support the twin goals of poverty reduction and shared prosperity through improving the institutional environment for microfinance providers and women's access to finance.

### C. Proposed Development Objective(s)

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

Key Results

The expected result from Prior Action 1 is maintaining fiscal discipline and making government's fiscal position more sustainable. The expected result from Prior Action 2 is an increased tax compliance, leading to a higher tax revenue as a share of GDP over the medium term (i.e. going beyond the current DPO implementation timeframe). The expected result from Prior Action 3 is the development of a vision toward rationalizing the tax incentives' regime, aimed at broadening the tax base and contributing to a higher level of tax revenue as a share of GDP. For Prior Action 4, among the many improvements that the PFM reforms supported by this DPO series have the potential to underpin, is greater accountability and transparency in the use of public funds. Timely submission of the annual financial statements for audit is critical to the potential effectiveness of external oversight institutions. For Prior Action 5, the combined result of the implementation of the strategies and policies supported by the DPO series – including the establishment of the National Switch supported under this operation – is expected to be increased financial inclusion, particularly for women.

### D. Concept Description

The proposed operation supports five key components of the government's development program, as articulated in the MTDP III, the MTFS, and the MTRS. The first component is improved fiscal management, where the government aims to strengthen fiscal resilience to resource-based volatility by establishing the non-resource primary balance as a medium-term fiscal anchor. The second is increased revenue mobilization, where the government aims to reverse the recent declining trend in tax revenue to GDP by broadening the tax base, providing clear revenue administration legislation, and operating a fair and efficient revenue administration. The third is improved governance, where the government aims to continue the implementation of key PFM reforms, to improve the efficiency of public resource use and promote greater accountability and transparency. The fourth is women's economic empowerment, as part of which government's aims to strengthen financial inclusion for women. The fifth is SME growth, within which the government aims to increase access to finance for SMEs.

The design of this operation has incorporated some of the key lessons learned from the last series of policy-based operations in PNG. The Governance Promotion Adjustment Loan approved by the Board in May 2000 was a particularly challenging operation, and the current DPO is part of the first series of policy-based engagements in PNG since then. There are three lessons from the Implementation, Completion and Results Report from the earlier adjustment loan that are particularly pertinent to the current engagement. The first is the importance of a stable social and political environment and strong country ownership and commitment to support macroeconomic and structural reforms. The history of governing coalitions in PNG suggests that the policy environment can be unpredictable. Given the relatively recent strengthening of the Bank's economic policy dialogue with the GoPNG, the team has focused on policy actions that the government has already made significant investments in or that have broader political support, so as to mitigate the possibility of policy reversal even if there is a change in the political environment. The second lesson is the importance of the Bank and country counterparts having common expectations on all key components of the engagement, including the specific requirements of the prior actions, to avoid a situation where differences in expectations lead to delays. The team has worked and will continue to work with government counterparts to make the specific requirements of all key components of the DPO series as clear as possible. The third lesson is the value of establishing a team in the government that includes policymakers who are responsible for the implementation of each of the prior actions – so they can work collectively to help keep the program on track. This mechanism has been established under the leadership of the Department of Treasury (DoT), comprising the heads of all of the divisions covered by the policy matrix, and is working well.

Consistent with government priorities and the above lessons, the Program Development Objective (PDO) of the proposed operation is to: (i) strengthen fiscal management and revenue performance; and (ii) strengthen key building blocks for public financial management and financial inclusion. Under the first part of the PDO, the operation supports adherence to the non-resource primary balance as a fiscal anchor, measures to improve tax administration and compliance, and the review of tax expenditures. These reforms are directly aligned with the fiscal management and revenue mobilization components of the government's program. The second part of the PDO, under which the operation supports the bringing up to date of bank reconciliations – a critical financial control – in national departments, and measures to increase financial sector development which will be of particular benefit to microfinance institutions and women – is directly aligned with the governance, women's economic empowerment and SME growth components of the government's program. The first and second parts of the PDO are expected to contribute to poverty reduction and shared prosperity by improving medium-term fiscal stability, the sustainability of public expenditures, and the execution of the annual budget – crucial foundations for the delivery of public education, health and infrastructure which are all of critical importance to the poor – and by improving the institutional environment for microfinance providers and women's access to finance. Of the five indicative triggers in the policy matrix for the proposed operation, four are on track and one requires revision for conversion into a prior action.

## E. Poverty and Social Impacts and Environmental Aspects

### Poverty and Social Impacts

The prior actions supported under the first pillar are likely to have an indirect, positive effect on poverty reduction, including on women. Prior action 1 focuses on improving the management of volatile resource revenue by adhering to a fiscal policy framework that aims at reducing the procyclicality of government spending. Previously, procyclical government spending, correlated with resource revenue receipts, has typically led to inefficient spending, higher wages and higher inflation during periods of high commodity prices, and to sharp compressions of public spending and rising unemployment during periods of low commodity prices, which has generally led to negative impact on the poverty profile. Adherence to the non-resource primary balance fiscal anchor supports a more stable public expenditure profile which should help to insulate public expenditure from the vagaries of the commodity price cycle and contribute to a more stable public expenditure profile in support of 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. As the crisis in health services in PNG in recent years has shown, delivery of key public services can be disproportionately important to women and children (with primary care and health outreach in all geographic areas critical to maternal, reproductive and child health, in particular). Raising revenue via the actions supported under this pillar will allow for continued capital expenditure, which has been bearing the brunt of the fiscal consolidation efforts in the face of lower revenue receipts. Capital expenditure is generally productive, as it is investment into future growth which is expected to support poverty reduction. Moreover, since the revenue actions focus on boosting compliance to generate revenue and reviewing tax expenditure, these actions are unlikely to adversely affect the poor or poor women, in particular. These actions are intended to boost revenue so that government has increased funds for public service delivery, again of disproportionate importance to the poor, and in particular women and children.

The prior actions supported under the second pillar of the operation are expected to have either indirect or direct positive poverty and social effects, including a direct effect on closing the gender gap in the area of financial inclusion. Over the medium term, the rollout of the IFMS is expected to lead to better budget execution – by ensuring that budgeted resources are available and actually used to support the service delivery activities they were approved for, and that accurate reports can be generated and published in a timely way to enable both policymakers and the public to verify this. Given that poorer quintiles are typically more dependent on the availability of public services like primary schools and health clinics than richer quintiles – and that women have a particular reliance on these services in areas of maternal and reproductive health, access to education, and personal security/law and order – reforms that improve budget execution can be expected to be of disproportionate benefit to the poor and women– albeit an indirect benefit of the reforms. The measures to support increased financial inclusion – particularly for women – are expected to have positive poverty and social impacts and a specific positive impact on financial inclusion for women, through increasing access to finance for the poor and, particularly, for women.

### Environmental Impacts

The prior actions supported under this operation are not expected to have significant effects on PNG's environment, forests or natural resources. That includes the prior actions on adhering to the medium-term fiscal anchor, strengthening revenue administration and enhancing revenue compliance, reviewing tax expenditure, bringing bank reconciliations in national departments up to date, and introducing a new National Switch platform, which in the team's judgement will not have significant environmental effects.

While there are policies governing environmental impact assessment in PNG, implementation of these policies is limited. The Conservation, Environment and Protection Authority (CEPA) is mandated and responsible for environmental impact assessment. Four levels of assessment are defined with the regulation, approval for projects commences with the Notification of project to CEPA who will determine whether the project is assessed as level 1 requiring no approval, level 2A and 2B requiring an application or level 3 requiring an application and being submitted to full Environmental Impact Assessment (EIA). Other relevant institutions include; Agriculture, Forestry, Fisheries, Lands, National Planning and Monitoring, Mining and Petroleum, Health, Education, City Authorities such as the NCDC, Local Level Government and Landowner groups. However, coordination is weak between these different agencies and government departments is weak resulting in poor implementation of policies and standards. Moreover, limited capacity due to a shortage of skills and funding, limit CEPA's ability to process and review EIAs, particularly for the more complex proposals with more comprehensive EIA requirements. There may be opportunities to strengthen capacity through the Bank's infrastructure project pipeline.

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## APPROVAL

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### Approved By

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